Supreme Court, U.S.
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No. _____

IN THE

# Supreme Court of the United States

LASZLO N. TAUBER, *et al.*,
*Petitioners*,

v.

COMMONWEALTH OF VIRGINIA, *ex. rel.*, JERRY W. KILGORE, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA, *et al.*,
*Respondents.*

**On Petition For Writ of Certiorari To The Supreme Court of Virginia**

## PETITION FOR WRIT OF CERTIORARI

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## QUESTION PRESENTED

Does the Commerce Clause, Full Faith and Credit Clause, or Due Process Clause mandate that the law of the state of incorporation governs a corporation's internal affairs, or may the fifty states impose conflicting legal requirements on the internal affairs of other states' corporations, thereby exposing corporate directors to massive liability (here $51 million) for actions that comply with the law of the state of incorporation?

## LIST OF PARTIES

All parties do not appear in the caption on the cover page. A list of all parties to the proceeding in the Supreme Court of Virginia is as follows:

Petitioners

Laszlo N. Tauber

Leslie L. Peters

Irwin S. Freedman

Estate of Samuel Burtoff

Michael A Corrado

Dan J. Feriozi

Leslie P. Gondor

Reginald P. McManus

Magdolna A. Iranyi

Estate of James H. Scully

Jefferson Memorial Hospital Joint Venture

Jefferson Memorial Hospital, Inc.

Jefferson Memorial Hospital Associates

Jefferson Memorial Hospital Corporation

Jefferson Corporation of Alexandria

The Tauber Foundation

The Charitable Remainder Unitrust

Respondents

Commonwealth of Virginia, *ex. rel.*, Jerry W. Kilgore, Attorney General of the Commonwealth of Virginia

Jerry W. Kilgore, Attorney General of the Commonwealth of Virginia

The Commonwealth's Attorney for the City of Alexandria

## RULE 29.6 DISCLOSURE

No petitioner has any parent corporation, and there is no publicly held company that owns ten percent or more of any petitioner's stock.

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## PETITION FOR WRIT OF CERTIORARI

Petitioners hereby petition for a writ of certiorari to review the judgment of the Supreme Court of Virginia, which applied Virginia law to transactions involving the internal affairs of a Maryland corporation. This petition asks the Court to determine whether the Constitution instead required the Supreme Court of Virginia to follow the internal affairs doctrine and apply the law of Maryland, the state of incorporation, to the transactions.

## OPINIONS BELOW

The second opinion of the Supreme Court of Virginia (Pet. App. 1a-31a), which followed the accounting phase of the proceedings below, is reported at 263 Va. 520, 562 S.E.2d 118 (Va. 2002). The opinions of the Circuit Court for the City of Alexandria, Commonwealth of Virginia from the accounting phase (Pet. App. 32a-62a) are unreported.

The first opinion of the Supreme Court of Virginia (Pet. App. 65a-77a), which followed the liability phase of the proceedings below, is reported at 255 Va. 445, 499 S.E.2d 839 (Va. 1998). The opinion of the Circuit Court for the City of Alexandria, Commonwealth of Virginia from the liability phase (Pet. App. 78a-90a) is unreported.

## JURISDICTION

The final judgment of the Supreme Court of Virginia was entered on April 19, 2002. (Pet. App. 1a, 91a.) Petitioners filed a timely petition for rehearing on May 17, 2002, which the Supreme Court of Virginia denied on June 7, 2002. (*Id.* at 91a.) The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

## CONSTITUTIONAL PROVISIONS INVOLVED

This petition raises issues under the following clauses of the United States Constitution: Article I, section 8, clause 3 (the Commerce Clause); Article IV, section 1 (the Full Faith and Credit Clause); and Amendment XIV, section 1 (the Due Process Clause). The text of these provisions is set forth in the Appendix at page 92a.

## STATEMENT OF THE CASE

This case concerns the Supreme Court of Virginia's application of Virginia law to the internal affairs of a Maryland corporation that operated Jefferson Memorial Hospital, an acute care hospital in Alexandria, Virginia. The individual petitioners are a group of physicians that opened the hospital in 1965 without any public financial assistance as a charitable endeavor, accepting all patients regardless of their ability to pay. Petitioners operated the hospital until 1982, when a national medical care provider purchased the hospital. In adjudicating disputes over corporate transactions involving this entity, the Supreme Court of Virginia applied Virginia law to its internal affairs, even though the corporation was incorporated in Maryland. The question presented here is whether the Constitution required the Supreme Court of Virginia to apply the law of the state of incorporation to the internal affairs of this foreign corporation.

### A. Background

In 1965, the individual petitioners founded Jefferson Memorial Hospital, Inc. ("JMHI"), a Maryland non-profit corporation, to operate the hospital. Petitioners served on the Board of Trustees of JMHI and also practiced medicine at the hospital. Because the corporation lacked public funding and the Board of Trustees was committed to charitable care,

JMHI eventually developed serious financial problems that threatened its ability to continue in business. Legal counsel to JMHI's Board recommended addressing these issues by reorganizing JMHI from a non-profit to a for-profit corporation. JMHI accepted counsel's recommendation through the majority vote of its Board.

In 1971, JMHI's Board took the steps their attorney advised were necessary to effectuate the corporate reorganization. Petitioners formed (and held the shares of) a new for-profit Delaware corporation named Jefferson Memorial Hospital Corporation ("JMHC"). JMHC then acquired JMHI's considerable liabilities and meager assets. Following the 1971 transaction, petitioners operated the hospital, through JMHC, as a for-profit business. Since JMHI no longer operated the hospital, petitioners allowed JMHI's corporate charter to lapse in 1973.

In late 1974, counsel informed petitioners that all of the necessary steps had not been taken to make the 1971 transaction legally effective. Petitioners thereafter retained new counsel to advise them about how to confirm that the acquisition by JMHC was complete. The new counsel arranged for the appraisal of each of the assets that JMHI had transferred to JMHC. The appraisal confirmed that JMHI's liabilities exceeded the value of its assets. Following the appraisal, the new counsel advised that the transaction was fair to JMHI.

In 1975, the JMHI Board took the actions recommended by counsel to complete the acquisition by JMHC. The minutes of the special meeting of the JMHI Board, held to wind up the affairs of JMHI, stated:

> After a full discussion of the problems of the corporation by the members, and of the resolution from the Board of Directors to the members recommending the approval of the sale of the

> corporation's assets, in consideration of the assumption of its liabilities, it was duly moved, seconded and unanimously carried, that the sale of the corporation's assets to Jefferson Memorial Hospital Corporation, a Delaware Corporation, as recommended by the Board of Directors of this corporation, be and the same is hereby approved as being in the best interests of this corporation and its creditors.

(2d Appeal J. App. 2902-03.) Each of the members of the JMHI Board signed the minutes of this special meeting, albeit under the title of "director" instead of the title of "trustee." The new counsel advised that no further action by petitioners was necessary to liquidate and wind up JMHI.

Petitioners continued to operate the hospital, through JMHC, as a for-profit business. In 1982, JMHC sold the hospital operations, assets and liabilities to a national medical care provider.

### B. This Litigation

On April 26, 1995, the Virginia Attorney General commenced this action against petitioners on behalf of the Commonwealth of Virginia, asserting that the corporate reorganization of JMHI was an invalid insider transaction that breached petitioners' fiduciary duties to JMHI under Virginia statutes and Virginia common law. (Pet. App. 121a-123a ¶¶ 62-65.) The Virginia Attorney General asserted that the transfer was a breach of petitioners' fiduciary obligations, because the value of the assets transferred by JMHI to JMHC allegedly exceeded the liabilities assumed. (*Id.* at 119a ¶¶ 50-52.) The Virginia Attorney General sought imposition of a constructive trust, an award of hospital buildings and related real estate, and damages of $4 million on behalf of the citizens of Virginia. (*Id.* at 123a-124a.) The proceedings in

this action were bifurcated, with a trial on liability in January 1997 and an accounting trial in February 2000.

### 1. The First Trial

At the 1997 liability trial, the Circuit Court of Alexandria, Virginia held that petitioners had breached their fiduciary duties to JMHI by approving the 1971 transaction. (Pet. App. 80a-82a.)

During the trial, petitioners argued that Maryland law governed the 1971 transaction under the internal affairs doctrine, which holds that the law of a single state – the state of incorporation – governs a corporation's internal affairs. (Pet. App. 112a-116a.) Under Maryland law, an insider transaction involving corporate directors is lawful, and cannot be voided, if the transaction is fair to the corporation. *See Chesapeake Constr. Corp. v. Rodman*, 261 A.2d 156 (Md. 1970); Md. Corp & Assns § 2-419 (2002) (adopted in 1976 as codification of existing common law). The trial court's findings established that the 1971 transaction was fair to JMHI, by concluding that petitioners had "carried their burden of showing that the value of the corporation did not exceed its liabilities." (Pet. App. 82a.) Because the transaction relieved JMHI of its negative net worth (by transferring JMHI's assets to JMHC along with debts and liabilities exceeding the value of those assets), the transaction was fair to JMHI. Accordingly, application of Maryland law would have required entry of judgment for petitioners.

The trial court nonetheless held that Maryland law did not apply. The trial court concluded that petitioners' "reliance on the prohibition against the Commonwealth from regulating the 'organization and internal affairs of a foreign corporation'" was misplaced. (Pet. App. 79a.) The court then applied Virginia law, which provides that an insider transaction involving a nonprofit corporation is voidable even

if it is fair to the corporation. (*Id.* at 83a-84a; *see also Hanshaw v. Day*, 202 Va. 818 (1961).) This application of Virginia instead of Maryland law determined the outcome of the trial. The trial court voided the 1971 transaction and imposed a constructive trust over JMHI's assets.

### 2. The First Appeal

Petitioners appealed the trial court's interlocutory liability ruling to the Supreme Court of Virginia, arguing *inter alia* that the trial court had erred by failing to apply Maryland law to the internal affairs of JMHI. Petitioners argued that the Commerce Clause, Full Faith and Credit Clause, and Due Process Clause required application of Maryland law pursuant to the internal affairs doctrine. Petitioners noted that the highest courts in other states, most notably Delaware in *McDermott, Inc. v. Lewis*, 531 A.2d 206 (Del. 1987), have expressly held that the law of the state of incorporation controls such matters.

The Supreme Court of Virginia affirmed the liability ruling. The court acknowledged that "[petitioners] and their supporters think this case involves the improper meddling by the Commonwealth into the internal affairs of a Maryland Corporation, contrary to settled law and violative of the Full Faith and Credit, Due Process and Commerce Clauses of the United States Constitution." (Pet. App. 74a.) However, without explanation, the court summarily concluded that "[t]his case involves none of the above." (*Id.*) The court also held that "defendants' contentions that this litigation . . . involves impermissible interference by Virginia with the internal affairs of a foreign corporation, or that a 'fairness' doctrine should be applied to the 1971 activities, are without merit." (*Id.* at 76a.)

Petitioners filed a petition for certiorari in this Court, seeking review of the Supreme Court of Virginia's ruling.

This Court denied the petition for certiorari on November 2, 1998. (Pet. App. 63a.)[1]

### 3. The Second Trial

On remand, the trial court performed an accounting to calculate the amount of petitioners' liability. As part of the accounting, the court conducted a trial to identify the assets of JMHI at the time of its dissolution. A major issue at trial was determining the time of the dissolution, which established the point at which an accounting was appropriate. Petitioners argued that the court should apply Maryland law, rather than Virginia law, to resolve the issue. (Pet. App. 105a-110a.)

Under Maryland law, the accounting would have been performed as of 1975, when JMHI took its actions to confirm the effectiveness of the 1971 acquisition by JMHC. Because JMHI's liabilities exceeded its assets at that time, the 1975 transaction was fair to the corporation and therefore not voidable under Maryland law. In addition, the 1975 transaction fit the description of a corporate dissolution provided by the Commonwealth of Virginia's own expert, who explained that a non-profit corporation can change legal form to a for-profit corporation by "dissolving and then by selling those assets and then by having another corporation begin to carry on the same business." (2d Appeal J. App. 0093.) Petitioners argued that performing the accounting as

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[1] It is well established that the denial of a petition for certiorari concerning an interlocutory ruling does not preclude the grant of a petition for certiorari seeking review of the final judgment in the case. *See, e.g., United States v. Virginia,* 518 U.S. 515, 526 (1996); *Hanover Shoe, Inc. v. United Shoe Mach. Corp.,* 392 U.S. 481, 488 n.6 (1968); *Toledo Scale Co. v. Computing Scale Co.,* 261 U.S. 399, 418 (1923). The present petition seeks review of the final judgment below.

of 1975 would yield an award to the Commonwealth of approximately $900,000.[2]

The trial court rejected petitioners' arguments and applied Virginia law to determine the time of dissolution. (Pet. App. 60a (citing *Hanshaw*, 202 Va. 818).) The court concluded that it must perform the accounting as of the time of trial, on the ground that the court had voided any prior dissolutions of JMHI. The court's accounting tallied revenues through 2005, totaling $51 million. The court then limited the award to $20 million, an amount the court considered "fair and just under all of the circumstances." (Pet. App. 61a.) The court also awarded the Commonwealth hospital buildings and related real estate. (*Id.* at 60a-61a.)

### 4. The Second Appeal

Petitioners appealed to the Supreme Court of Virginia, arguing that "the trial court erred by applying Virginia law to determine the liability of the directors or trustees in dissolution of the Maryland not-for-profit corporation JMHI and to govern the distribution of this entity's assets." (Pet. App. 101a.) The Supreme Court of Virginia affirmed. Holding that Virginia rather than Maryland law applied, the court ruled that the petitioners were not authorized to enter into any insider transaction, regardless of the transaction's fairness. (*Id.* at 16a.) The court further held that the 1975 and 1982 transactions were without legal effect because there is "no indication that the transactions in 1975 and 1982 were

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[2] Petitioners argued in the alternative that the dissolution occurred in 1982, when the hospital was sold outright to the national medical care provider. Petitioners argued that performing the accounting as of 1982 would yield an award of approximately $1.5 million.

entered into by the defendants as trustees in dissolution of JMHI, . . . rather than as directors of JMHC. . . ." (*Id.*) Finally, the court increased the award from $20 million to $51 million, holding that the trial court was precluded from adjusting the award due to considerations of fairness and justice. (*Id.* at 28a-29a.)

Petitioners filed a petition for rehearing, arguing that their actions were effective in 1975 and 1982, whether taken as "directors" or "trustees in dissolution." (Pet. App. 96a-99a.) While Virginia law may ignore a transaction taken under the wrong name or title, Maryland law provides that an action is effective, even if taken under the wrong name or title, if the person has the authority in some other capacity. *Cloverfields Improvement Ass'n, Inc. v. Seabreeze Properties, Inc.*, 280 Md. 382, 399, 373 A.2d 935 (1977) (citing *Flickinger v. Hull*, 5 Gill. 60, 74-75 (1847)). Petitioners argued that the Supreme Court of Virginia's "refusal to give effect to the 1975 transaction because the JMHI board members signed the minutes as directors, rather than trustees in dissolution, violates the Full Faith and Credit Clause of the United States Constitution." (Pet. App. 98a-99a.) The Supreme Court of Virginia denied the petition for rehearing on June 7, 2002. (*Id.* at 91a.)

This petition followed.

## REASONS FOR GRANTING THE PETITION

This case presents the question whether the Constitution required the Supreme Court of Virginia to follow the internal affairs doctrine, which holds that the law of the state of incorporation governs a corporation's internal affairs. This Court has repeatedly recognized the importance of the doctrine, which establishes predictable and uniform rules about internal corporate matters, as essential to the nation's free market system. The Supreme Court of Virginia nonetheless refused to follow the doctrine, applying Virginia law to the internal affairs of a Maryland corporation and imposing $51 million in liability for acts that complied with Maryland law.

This Court's decisions suggest that the internal affairs doctrine derives from the requirements of the Commerce Clause or the Full Faith and Credit Clause, and the Court also has held that choice of law decisions may implicate the Due Process clause. However, the Court has never squarely addressed the question whether the internal affairs doctrine is constitutionally required, and if so, under which constitutional provision or provisions. Lacking guidance from this Court, the highest courts of numerous states, including the court below, have divided over their application of the doctrine. The Court should grant the petition to clarify whether the Constitution mandates that the law of the state of incorporation governs a corporation's internal affairs.

## I. THE COURT SHOULD GRANT THE PETITION TO DECIDE AN IMPORTANT FEDERAL CONSTITUTIONAL QUESTION THAT HAS NOT BEEN, BUT SHOULD BE, SETTLED BY THIS COURT

### A. The Internal Affairs Doctrine is Essential to the Efficient Operation of the Nation's Market Economy

This Court has recognized the national significance of the internal affairs doctrine, which is "a conflict of laws principle which recognizes that only one State should have the authority to regulate a corporation's internal affairs – matters peculiar to the relationships among or between the corporation and its current officers, directors, and shareholders – because otherwise a corporation could be faced with conflicting demands." *Edgar v. MITE Corp.*, 457 U.S. 624, 645 (1982). The doctrine "achieves the need for certainty and predictability of result while generally protecting the justified expectations of parties with interests in the corporation." *First Nat'l City Bank v. Banco para el Comercio Exterior de Cuba*, 462 U.S. 611, 621 (1983). As a result, the Court has recognized the doctrine as exceptionally important to the national market economy:

> This beneficial free market system *depends at its core* upon the fact that a corporation – except in the rarest situations – is organized under, and governed by, the law of a single jurisdiction, traditionally the corporate law of the State of its incorporation.

*CTS Corp. v. Dynamics Corp. of Am.*, 481 U.S. 69, 90 (1987) (emphasis added).

### B. This Court Has Never Expressly Resolved Whether the Doctrine is Constitutionally Required

This Court has never squarely addressed whether the Constitution mandates application of the internal affairs doctrine, despite its manifest national significance and the statements of other courts and scholars that the doctrine is constitutionally required.[3] There is strong support in this Court's decisions for the proposition that the doctrine derives

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[3] *See McDermott,* 531 A.2d at 216 (internal affairs doctrine is "one of serious constitutional proportions"); *TLX Acquisition Corp. v. Telex Corp.*, 679 F. Supp. 1022, 1030-31 (W.D. Okla. 1987) (grounding the internal affairs doctrine in the Commerce Clause). *See also* Robert Suggs, "Business Combination Antitakeover Statutes: The Unintended Repudiation of the Internal Affairs Doctrine and Constitutional Constraints on Choice of Law," 56 Ohio St. L.J. 1097, 1152 (1995) (discussing the constitutional implications of the internal affairs doctrine and proposing that "[t]he only sensible course is to clarify the law by constitutionalizing the internal affairs doctrine as *CTS* strongly implied"); Theresa L. Kelly, "Draper v. Gardner: Just Another Battle in the Conflicts Revolution?," 19 Del. J. Corp. L. 546, 549 (1994) ("One explanation for this continued adherence to the internal affairs doctrine may be its constitutional underpinnings."); Paul N. Cox, "The Constitutional 'Dynamics' of the Internal Affairs Rule – A Comment on CTS Corporation," 13 J. Corp. L. 317, 319 (1988) (suggesting that this Court's ruling in *CTS* "may have long-term significance for the doctrine of full faith and credit and, therefore, choice of law within the corporate law context"); Richard M. Buxbaum, "The Threatened Constitutionalization of the Internal Affairs Doctrine in Corporation Law," 75 Calif. L. Rev. 29, 54 (1987) (*CTS* "embed[ed] . . . the state-of-incorporation version of the internal affairs doctrine in the Constitution via the dormant commerce clause"); P. John Kozyris, "Corporate Wars and Choice of Law," 1985 Duke L.J. 1, 35 (1985) ("[T]here is little question that *Edgar v. MITE Corp.* gave the single-law and lex incorporationis principles an indirect but significant boost under the commerce clause").

from the Constitution. For example, the Court has held that the dormant Commerce Clause may invalidate state statutes that purport to regulate the activities of corporations incorporated in other states. In *Edgar*, the Court held that an Illinois statute that purported to regulate tender offers involving corporations not incorporated in Illinois violated the Commerce Clause. In its Commerce Clause analysis, the Court noted that "Illinois has no interest in regulating the internal affairs of foreign corporations." *Edgar*, 457 U.S. at 645-46. By contrast, in *CTS Corp.*, the Court held that an Indiana statute that did not regulate corporations incorporated in other states did not violate the Commerce Clause. *CTS Corp.*, 481 U.S. at 89. The Court suggested that it would invalidate a statute under the Commerce Clause if such a statute "create[d] an impermissible risk of inconsistent regulation by different States." *Id.* at 88-89.

The Court also has held that the Full Faith and Credit Clause governs choice of law rulings involving entities that are not corporations. The Court has ruled that the Full Faith and Credit Clause requires that the law of the state under which a fraternal organization has been organized must be respected when another state's courts adjudicate matters involving the organization's internal affairs. *See Order of United Commercial Travelers of Am. v. Wolfe*, 331 U.S. 586, 606-07 (1947) ("It is this dependence of membership rights upon the public acts of the domiciliary state, supported by the requirement that full faith and credit shall be given in each state to those public acts, that has been recognized by this Court in the unbroken line of decisions reviewed in this opinion"); *Sovereign Camp of the Woodman of the World v. Bolin*, 305 U.S. 66, 79 (1938) ("Under our uniform holdings the court below failed to give full faith and credit to the petitioner's charter embodied in the statutes of Nebraska as interpreted by its highest court.").

Finally, the Court has recognized that the Due Process Clause may impose limitations on a court's choice of law decisions. *See Allstate Ins. Co. v. Hague*, 449 U.S. 302, 327 (1981) (Stevens, J. concurring) ("A choice-of-law decision that frustrates the justifiable expectations of the parties can be fundamentally unfair.").

The Court has never had the opportunity to integrate these analyses under the Commerce Clause, Full Faith and Credit Clause, and Due Process Clause and directly address which, if any, of these provisions mandates application of the law of the state of incorporation to a corporation's internal affairs. The Court also has never elaborated upon its suggestion that there are "rare[] situations" in which the internal affairs doctrine does not apply. *CTS Corp.*, 481 U.S. at 90.

The Court should grant the petition to resolve these important constitutional issues. It is a significant question whether the federal Constitution mandates all of the states to follow the same choice of law rule concerning internal corporate matters, or whether the states are instead free to adopt divergent rules as a matter of federalism. If the fifty states were able to apply their own laws to the internal affairs of foreign corporations, a chaotic system would result, with a multitude of conflicting legal requirements imposed on the same corporate actions. As one commentator has recognized, it would be "intolerable to allow [a corporation's] component parts to be regulated under differing principles for different persons at different times. Rather, such a regime must be uniform and stable to promote efficient and equitable operation." Kozyris, 1985 Duke L.J. at 49. The General Counsel of the American Council on Education specifically recognized the havoc that a non-uniform regime would wreak on the nation's nonprofit corporations when he criticized the Supreme Court of Virginia's first ruling in this case:

> If the ruling is upheld, it potentially subjects governing bodies of nonprofit institutions – including colleges and universities – to liability under the laws of the state in which the institutions are incorporated and in every state in which the institution has a presence.

Steinbach and Pelesch, "Unfriendly Territory," TRUSTEESHIP, May/June 1998 at 27.

At a time when corporate officers and directors are coming under increasing scrutiny, it is particularly important for this Court to clarify whether they may rely on the internal affairs doctrine to provide a predictable guide for their actions. The Court should grant the petition to clarify the constitutional requirements in this critical area.

## II. THE COURT SHOULD GRANT THE PETITION TO RESOLVE DIVISIONS AMONG THE STATES' HIGHEST COURTS OVER APPLICATION OF THE INTERNAL AFFAIRS DOCTRINE

The Court also should grant the petition to resolve divisions among the states' highest courts over application of the internal affairs doctrine. The rulings of the Supreme Court of Virginia below are wholly inconsistent with rulings of the Supreme Court of Delaware holding that the internal affairs doctrine is constitutionally required. This division exacerbates a divergence between the highest courts of at least four states that uniformly subscribe to the internal affairs doctrine and the highest courts of at least four other states that reject uniform application of the doctrine.

The Supreme Court of Virginia's rulings below rejected petitioner's arguments that the Full Faith and Credit Clause, Commerce Clause and Due Process Clause required application of Maryland law to the internal affairs of JMHI.

*See supra* at 6, 8-9. Those rulings do not square with decisions of the Supreme Court of Delaware, which is the leading state court authority on corporate jurisprudence. In *McDermott,* that court expressly ruled that the internal affairs doctrine derives from the requirements of the Full Faith and Credit Clause, Commerce Clause and Due Process Clause:

> [T]he internal affairs doctrine is not merely a principle of conflicts law. It is also one of serious constitutional proportions – under due process, the commerce clause and the full faith and credit clause – so that the law of one state governs the relationships of a corporation to its stockholders, directors and officers in matters of internal corporate governance. The alternatives present almost intolerable consequences to the corporate enterprise and its managers. With the existence of multistate and multinational organizations, directors and officers have a significant right, under the fourteenth amendment's due process clause, to know what law will be applied to their actions.

*McDermott*, 531 A.2d at 216.[4] *See also Draper v. Paul N. Gardner Defined Plan Trust*, 625 A.2d 859, 864 (Del. 1993) (reaffirming constitutional basis for internal affairs doctrine as discussed in *McDermott*).

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[4] *McDermott* held that the constitutional requirements have limits, and that "full faith and credit commands application of the internal affairs doctrine except in the *rare* circumstance where national policy is outweighed by a significant interest of the forum state in the corporation and its shareholders." *McDermott*, 531 A.2d at 218 (emphasis in original).

The conflict in principle between the highest courts of Virginia and Delaware magnifies a pre-existing division among the highest courts of other states. The Supreme Court of Delaware has expressly held that its application of the internal affairs doctrine diverges from that of New York's highest court, which rejects "any automatic application of the so-called 'internal affairs' choice-of-law rule." *Greenspun v. Lindley*, 36 N.Y.2d 473, 478 (N.Y. 1975). In *McDermott*, the Supreme Court of Delaware explained that its application of the internal affairs doctrine conflicted with New York law as explicated by the Second Circuit in *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255 (2d Cir. 1984). In *Norlin*, the Second Circuit had followed the New York Court of Appeals' decision in *Greenspun* and applied New York corporate law to the internal affairs of a Panamanian corporation with significant New York contacts. *Norlin*, 744 F.2d at 263. The Supreme Court of Delaware expressly "decline[d] to follow *Norlin*" and "reaffirm[ed] the principle that the internal affairs doctrine is a major tenet of Delaware corporation law having important federal constitutional underpinnings." *McDermott*, 531 A.2d at 209.

The rulings of the Supreme Court of Delaware also diverge from those of the Supreme Court of California over the application of the internal affairs doctrine. California has long rejected any automatic application of the internal affairs doctrine. *See Wait v. Kern River Mining, Milling & Developing Co.*, 106 P. 98, 100 (Cal. 1909) (applying California law to a dispute concerning ownership of stock in an Arizona corporation); *Atkinson v. Superior Court of Los Angeles County*, 316 P.2d 960, 965 (Cal. 1957) (citing *Wait* as good law). Although the Supreme Court of California has not expressly rejected a constitutional basis for the doctrine,

the California intermediate appellate court has done so, holding that the doctrine is not constitutionally required.[5] The Supreme Court of Delaware expressly disagrees with the constitutional jurisprudence of the California intermediate appellate court.[6]

The divergence between the rulings of the Supreme Court of Delaware on the one hand, and the highest courts of Virginia, New York and California on the other, extends to numerous other states as well. For example, like the Supreme Court of Delaware, the highest courts of Georgia, Kansas, Maryland and Massachusetts uniformly apply the internal affairs doctrine, although they have not expressly

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[5] *See Western Air Lines, Inc. v. Sobieski*, 191 Cal. App. 2d 399, 411 (Cal. Dist. Ct. App. 1961) (finding that California legislative actions applying to the internal affairs of foreign corporations are "not violative of the constitutional clauses of equal protection, contract, due process and full faith and credit if such legislative enactments operate equally upon such foreign corporations and domestic corporations in this state"); *Wilson v. Louisiana-Pacific Res., Inc.*, 138 Cal. App. 3d 216, 222-31 (Cal. Dist. Ct. App. 1982) (explaining that California's rejection of the internal affairs doctrine does not violate full faith and credit, the commerce clause, the contract clause, equal protection, and due process).

[6] In *Draper*, the Supreme Court of Delaware dismissed the California intermediate appellate court's decision in *Western Air Lines* as obsolete, and reaffirmed the constitutional underpinnings of the internal affairs doctrine, anticipating that California would apply Delaware law to a Delaware corporation if the derivative action suit was voluntarily dismissed and refiled in California. *Draper*, 625 A.2d at 867. However, that very same year, the California court reasserted its *Western Air Lines* position by declining to apply the internal affairs doctrine in *Shields v. Singleton*, 15 Cal. App. 4th 1611 (Cal. Dist. Ct. App. 1993) (applying California law to a shareholder derivative action, even though Delaware was the state of incorporation).

articulated its constitutional basis.[7] By contrast, the highest courts of Colorado and Ohio reject uniform application of the doctrine.[8]

The state courts plainly need guidance concerning the federal constitutional requirements at issue, and this case is a

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[7] *See Diedrich v. Miller & Meier & Associates, Architects, and Planners, Inc.*, 334 S.E.2d 308, 310 (Ga. 1985) ("We hold that the wrongful appropriation of a business opportunity of a foreign corporation by its officer or director is an internal affair not to be regulated by Georgia law. Instead, the local law of the state of incorporation applies, which is Wisconsin in this case"); *Consolidated Beef Indus., Inc. v. Schuyler*, 716 P.2d 544, 549 (Kan. 1986) (holding that "[t]he generally accepted rule is that a corporation's charter and the laws of its domicile govern with respect to the fact and duration of corporate existence and the rights and liabilities of its officers, stockholders, and directors"); *NAACP v. Golding*, 679 A.2d 554, 559 (Md. 1996) (holding that Maryland courts will not interfere with the internal affairs of foreign corporations because "[t]hese powers belong only to the State which created the corporation"); *Harrison v. NetCentric Corp.*, 744 N.E.2d 622, 628 (Mass. 2001) ("Traditionally, we have applied the law of the State of incorporation in matters relating to the internal affairs of a corporation (including both closely and widely held corporations), such as the fiduciary duty owed to shareholder .... Today, we adhere to and reaffirm our policy that the State of incorporation dictates the choice of law regarding the internal affairs of a corporation."); *see also Slattery v. Bower*, 924 F.2d 6, 9 (1st Cir. 1991) ("Under Massachusetts law, any question pertaining to the duty owed by the director of a corporation is governed by the law of the state of incorporation").

[8] *Ficor, Inc. v. McHugh*, 639 P.2d 385, 391 (Colo. 1982) (applying Colorado law to determine the obligations of officers, directors, and shareholders to the creditors of a District of Columbia corporation); *Gries Sports Enters., Inc. v. Modell*, 473 N.E.2d 807, 810 (Ohio 1984) (applying Ohio law to determine the voting rights of minority shareholders pursuant to a voting agreement between shareholders of a Delaware corporation).

particularly good vehicle for addressing them. *First*, this case starkly presents the significant impact choice of law may have on the conduct of a corporation's internal affairs, because choice of law determined the outcome of both decisions by the Supreme Court of Virginia. As explained *supra* at 5-6, application of Maryland law instead of Virginia law in the first appeal would have required a finding of no liability, because the transaction between JMHC and JMHI was fair to JMHI. In the second appeal, application of Maryland law instead of Virginia law would have led to liability of $900,000 instead of an assessment of $51 million plus forfeiture of hospital buildings and real estate parcels. *See supra* at 7-8.

*Second*, this case presents an excellent opportunity to assess the Constitution's requirements for national uniformity under circumstances in which there has been a "parochial entrenchment on the interests" of one state by another state. *Thomas v. Washington Gas Light Co.*, 448 U.S. 261, 272 (1980) (purpose of Full Faith and Credit Clause is to prevent such entrenchment). One of the fifty states (*i.e.*, Virginia) is actually a *party* in this case, having initiated litigation in which it to date has successfully imposed its laws on the internal affairs of a foreign corporation. Virginia plainly has a strong vested financial interest in the application of Virginia law, which has allowed Virginia to prevail on both liability and damages. If the Supreme Court of Virginia's judgment is allowed to stand, the $51 million assessed and the buildings and real estate forfeited would be used to benefit Virginia's citizens. However, in order to advance its narrow local interests, Virginia, through its highest court, has imposed massive liability under Virginia law for acts that comply fully with Maryland law. In so doing, Virginia has encroached on the legitimate and well-recognized authority of Maryland to regulate its corporations' internal affairs. *See CTS Corp.*, 481 U.S. at 89 ("[n]o principle of corporation law and practice is

more firmly established than a State's authority to regulate domestic corporations"). Because Virginia's actions pose a "substantial threat to our constitutional system of cooperative federalism" (*Nevada v. Hall*, 440 U.S. 410, 424 n.24 (1979)), this Court should grant the petition and resolve the fundamentally important constitutional issues presented.

## CONCLUSION

The Court should grant the petition for certiorari.

Respectfully submitted,

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September 4, 2002

# APPENDICES

**APPENDIX A**

PRESENT: All the Justices

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Record No. 011150

LASZLO N. TAUBER, et al.

Appellants,

Against

COMMONWEALTH OF VIRGINIA, ETC. et al.,

Appellees.

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FROM THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA (Alfred D. Swersky, Judge)

OPINION BY JUSTICE
BARBARA MILANO KEENAN
April 19, 2002

In this appeal, we consider issues related to an accounting of the assets of a defunct charitable corporation. The chancellor awarded $20 million and certain real property to the Commonwealth for the public benefit after imposing a constructive trust on the assets of the corporation whose charter was revoked in 1973.

We initially considered issues arising from the diversion of assets of Jefferson Memorial Hospital, Inc. (JMHI) in Tauber v. Commonwealth, 255 Va. 445, 499 S.E.2d 839 (1998) (Tauber I). There, we affirmed the chancellor's judgment imposing a constructive trust on the assets of the defunct charitable corporation and we remanded the case to the chancellor for further proceedings. Id. at 450-51, 456, 499 S.E.2d at 842, 845. We will recite the relevant facts in the proceedings to date, including the inferences fairly

deducible from those facts, in the light most favorable to the Commonwealth, the prevailing party below. Id. at 452, 499 S.E.2d at 843; Hoffman Family, L.L.C. v. Mill Two Assocs. P'ship, 259 Va. 685, 696, 529 S.E.2d 318, 325 (2000).

Our standard of review on appeal is well established. As the trier of fact, the chancellor evaluated the testimony and the credibility of the witnesses. Johnson v. Cauley, 262 Va. 40, 44, 546 S.E.2d 681, 684 (2001); Advanced Marine Enters., Inc. v. PRC Inc., 256 Va. 106, 120, 501 S.E.2d 148, 156 (1998). Therefore, we will not set aside his findings on appeal unless they are plainly wrong or without evidence to support them. Nelson v. Davis, 262 Va. 230, 234, 546 S.E.2d 712, 715 (2001); Hudson v. Pillow, 261 Va. 296, 302, 541 S.E.2d 556, 560 (2001).

## I. BACKGROUND FROM TAUBER I

In the early 1960s, King Street Joint Venture (KSJV), through Laszlo N. Tauber, M.D., as trustee, acquired by deed and lease certain parcels of real estate located in the City of Alexandria. In 1963, JMHI obtained a charter in the state of Maryland as a "for-profit" corporation for the purpose of operating a hospital in Alexandria to be built on the acquired parcels of real estate. In 1964, JMHI amended its corporate charter to become a non-profit corporation and began operating the new hospital the following year. In 1966, KSJV was dissolved and its assets were transferred to Jefferson Memorial Hospital Associates (JMHA), a partnership conducted by Tauber as trustee.

In 1971, Jefferson Memorial Hospital Corporation (JMHC), a Delaware "for-profit" corporation, was formed and acquired the assets and liabilities of JMHA. Soon thereafter, a purported merger was attempted between JMHC and JMHI. As we observed in Tauber I, while "[t]his merger was reported on tax returns filed in 1972, . . . the record is devoid of documents to support such a transaction." Id. at 453, 499 S.E.2d at 843.

Also in 1972, the Internal Revenue Service issued a ruling revoking JMHI's tax-exempt status, retroactive to 1965, finding that JMHI engaged in transactions that resulted in "inurement of income to private individuals," in violation of Internal Revenue Code provisions allowing charitable corporations exemption from federal income taxation. In 1973, Maryland revoked JMHI's corporate charter.

In 1975, JMHC purportedly purchased the assets and assumed the liabilities of JMHI. The directors of JMHC thereafter authorized the transfer of all JMHC's assets to Tauber as trustee for Jefferson Memorial Hospital Joint Venture (JMHJV), "a partnership in which those assets apparently still reside." Id. at 449, 499 S.E.2d at 841. That same year, JMHJV "leased back" the transferred assets to JMHC.

In 1982, JMHC subleased Jefferson Memorial Hospital's operating license, liabilities, plant, equipment, and tangible and intangible assets to Health Group of Virginia, Inc. (HGV), a Tennessee corporation, for ten years in exchange for annual payments of about $1 million. A maximum of $240,000 of this amount was allocated toward payment of lease obligations owed to JMHJV, including payment of the $1.4 million mortgage that JMHJV had assumed from JMHI as part of the 1975 purported sale and "leaseback" transaction.

JMHJV amended its lease with JMHC to provide that JMHC would assign the proceeds from its sublease with HGV to JMHJV, except for the first $100,000 annually, in effect increasing JMHC's rental payments from $240,000 to $900,000 per year. Following the execution of this lease amendment, JMHJV built a new office building and garage complex (the Beauregard Building). JMHC later changed its name to Jefferson Corporation of Alexandria (JCA).

In 1985, Tauber alleged that HGV had breached the terms of its lease and negotiated a termination and buy-out of

the 1982 agreement by Fairfax Hospital Systems (INOVA). INOVA acquired HGV's stock for $5.8 million. In a lease agreement with JCA, in exchange for the operating license rights of the hospital, INOVA agreed to pay annual rent of about $1,375,000 under provisions that escalated to about $2.2 million in the year 2005. On the same date the INOVA lease was executed, JCA assigned "all of its right, title and interest" in the INOVA lease to Tauber as trustee for JMHJV.

In 1992, INOVA discovered problems in the chain of title to the hospital, which ultimately resulted in litigation between INOVA and JMHJV. In 1994, INOVA and JMHJV reached a settlement agreement (the 1994 INOVA Agreement), in which INOVA purchased all rights to operate the hospital, including the right to terminate hospital operations. Under the 1994 INOVA Agreement, possession of the land and hospital building reverted to JMHJV. In exchange for the operating license rights of the hospital, INOVA agreed to pay JMHJV over $2 million per year, with a final payment of $10 million in 2005.

In 1996, the Commonwealth of Virginia, ex rel. the Attorney General of Virginia and the Commonwealth's Attorney for the City of Alexandria (collectively, the Commonwealth), filed an amended bill of complaint against Tauber and nine other physicians. Each was sued "individually and as former directors and/or trustees and/or trustees in liquidation of [JMHI] . . . and/or its successors in interest, and/or as partners in [JMHA] . . . or [JMHJV], . . . and/or directors or shareholders of [JMHC] (a Delaware Corporation which changed its name to 'Jefferson Corporation of Alexandria')" (collectively, the defendants). The defendants also included JMHA, JMHJV, and JCA, as well as Tauber in his capacity as trustee and agent for JMHA and JMHJV.

In its amended bill of complaint, the Commonwealth alleged that the 1971 purported merger between JMHI and JMHC never occurred. The Commonwealth asked that the chancellor declare, among other things, that the defendants usurped JMHI's corporate opportunities and, thus, that legal title to JMHI's assets remained in JMHI. The Commonwealth also requested that the chancellor impose a constructive trust on the hospital building, the underlying land, equipment, and assets, and on the proceeds from the 1994 INOVA Agreement.

The chancellor held that the Commonwealth was entitled to the relief sought in its bill of complaint. In a March 1997 order, the chancellor declared that "the assets and liabilities of [JMHI] be, reside and remain with [the defendants] as trustees and further that a constructive trust be . . . imposed on such assets and liabilities." The chancellor also ordered the defendants to submit "a full and complete accounting of all assets and liabilities" that were subject to the chancellor's ruling.

In Tauber I, we affirmed the chancellor's judgment. Id. at 456, 499 S.E.2d at 845. We stated, in relevant part:

> The record amply supports the following findings of the chancellor. "There are numerous transactions shown, some of-record and some not, dealing with the real estate, the equipment, the leases, and the use of tax benefits. The transactions show an entire course of self-dealing by the directors of the charity. They were able to acquire interests in the real estate, the equipment and lease, and were able to use tax benefits belonging to the former charity to enhance the gain of the for-profit corporation. The record is replete with discussions among [defendants] as to their personal profits and gains with no reference to the best interests of the beneficiaries nor of the charitable corporation. The

> result was the total obliteration of the non-profit corporation."

Id. at 453-54, 499 S.E.2d at 843-44. We held that after the 1973 revocation of JMHI's corporate charter, by operation of law, JMHI's directors became trustees in dissolution of the charity. Id. at 455, 499 S.E.2d at 844. We stated that any actions thereafter taken by the defendants "as corporate officers, and not done to wind up or liquidate the business, were without effect because there was no corporation for which to act." Id., 499 S.E.2d at 844-45. We also concluded that the record clearly demonstrated that the defendants "failed and refused to execute the trust," and we remanded the case to the chancellor for further proceedings. Id. at 456, 499 S.E.2d at 845.

## II. EVIDENCE ON REMAND

On remand, the chancellor considered evidence concerning the value of JMHI's assets that were subject to the constructive trust. The record included the testimony of Celeste B. Vella, an attorney who testified in the original proceedings before the chancellor and qualified as an expert witness in the field of real estate transactions and title issues. Vella testified that JMHI owned the beneficial interest in several parcels of realty, including a portion of land that overlaps "Hopkins Parcel 1" and "Hopkins Parcel 2," a 65% undivided interest in the totality of Hopkins Parcels 1 and 2, and the "Berman Parcel."

Vella stated that she used the term "improvements" to refer to the buildings erected on the various properties, and that a majority of the hospital improvements were constructed on Hopkins Parcels 1 and 2. Vella observed that JMHA's financial statement and tax return for 1971 indicated that JMHA transferred ownership of the hospital improvements to JMHI on June 30, 1971. She also stated that JMHC's financial statement for 1971 indicated that JMHC acquired JMHA on July 1, 1971, one day after the

improvements were transferred to JMHI. Vella testified that in her opinion, title to both the land and the improvements JMHI owned in 1971 still remained in JMHI at the time of trial.

Vella also concluded that JMHI owned the beneficial interest in all the structures, including the hospital building, which were located on Hopkins Parcels 1 and 2 and the Berman Parcel. She stated that her opinion was based on an examination of record deeds, "off-record" deeds, leases, purchase agreements, corporate documents, federal tax returns, financial statements, letters, and the defendants' answers to interrogatories filed in the case.

Vella noted that, in 1975, JMHI purportedly conveyed its interest in a smaller portion of the above properties to JMHC, which in turn purportedly conveyed that portion to Tauber as trustee. However, Vella concluded that this transaction was void because JMHI no longer existed as a corporation after its 1973 charter revocation and "the appropriate parties were not joined in the deed in order to effect conveyance." In explaining her conclusion, Vella stated that "in order for the directors to act pursuant to a forfeited corporate charter, they would have to make this decision as trustees. And it appears from the minutes that they were acting as if JMHI still existed."

The Commonwealth also presented the testimony of Robert E. Wilson, a certified public accountant employed by Arthur Andersen LLP. Wilson stated that he conducted a fiduciary accounting of JMHI's assets based on the requirements specified in the chancellor's March 1997 decree, which directed disclosure of "all rents, issues, profits, accretions, and benefits, tangible and intangible, which have accrued therefrom." Wilson also explained that in conducting the accounting, he used a "conservative" approach that resolved any doubt in favor of the defendants.

Wilson testified that the right to operate the hospital and to generate income, which was secured by the hospital's operating license, was an asset subject to the constructive trust because JMHI never surrendered ownership of that license. He explained that "[t]he operating license is the engine . . . that runs this hospital. The bricks and mortar are simply the chassis. The value is in the license."

Wilson concluded that "[t]he reorganizations of the Hospital's operating entity appeared to be done with the primary intent of creating financial gain for the original investor group." He stated that the defendants' actions "stripped" JMHI of much of its value and severely undercapitalized the operation of the hospital. He explained that these actions required the charity "to absorb the burden of being a tenant . . . at a cost . . . in excess of what it would have been" had the charity owned and operated its own infrastructure, which purportedly had been transferred to the defendants' other "for-profit" enterprises.

Wilson stated that the defendants made only a single capital contribution to the charity, and that there were "many instances" in which they had received a return on their original investment "many times over." He also determined that the defendants commingled their personal funds with the assets of the charity, and that the activities of JMHJV "served to impair the fiscal stability of JMHI."

Wilson calculated the income generated from the assets held in trust by the defendants as trustees in dissolution, including the proceeds from the HGV and INOVA transactions and the 1994 INOVA Agreement. Wilson's calculations showed that as of June 30, 1999, JMHI had realized assets in the amount of $26,372,438 that were subject to the constructive trust. Wilson further determined that an additional $24,703,145 would accrue to the benefit of the constructive trust from July 1, 1999 through October 1,

2005, when INOVA is required to make final payment under the terms of the 1994 INOVA Agreement.

Wilson also addressed the methodology used by the defendants in the accounting they submitted to the chancellor. He testified that the defendants' submission was not a fiduciary accounting because it did not reflect what actually had transpired with regard to JMHI's assets. Wilson stated that he did not see evidence of "any recognition given to the accretion of any of the charity's assets at any point in time," and that the defendants did not account for the net operating losses of the charity. He described the defendants' methodology as the act of choosing four dates and attempting "to create a value judgment or estimation of value based upon the creation of balance sheets which have one foot in reality and one foot in hypothesis."

Wilson explained that valuation is relevant only "if you are winding up and liquidating a business, disposing of assets and liabilities." He stated that because JMHI was never "wound-up" or liquidated, "any valuation information at any point in time is nothing more than a reflection of what might be."

The defendants' accounting, prepared by Arthur H. Cobb, reported JMHI's assets only through 1973, when JMHI's corporate charter was revoked. Cobb also prepared value calculations that were based on certain assumptions, including the assumption that JMHI was liquidated in the alternative years of 1975, 1982, 1992, and 2005.

Cobb testified that JMHI was "undercapitalized" and had received only "one formal capital contribution," which was repaid within two years. He also stated that the hospital was merely a "white elephant" if its assets were considered apart from its operating license.

Cobb's accounting indicated that a liquidation of JMHI in April 1973 would not have yielded any net proceeds,

because total liabilities would have exceeded total assets. Cobb reached a similar conclusion for the hypothetical liquidation of JMHI on July 1, 1975, the date of the sale and "leaseback" transaction with JMHJV. He also estimated that a hypothetical liquidation of JMHI in 1982, at the time of the HGV transaction, would have resulted in about $1,254,000 in net proceeds.

Cobb prepared calculations involving a hypothetical liquidation year of 1992, "based on JMHI participating in leasing or sub-leasing certain land, building and related equipment, furniture and fixtures" to HGV and to INOVA. Under this assumption, Cobb estimated that liquidation of JMHI's business at the end of 1992 would have resulted in about $5,462,000 in net proceeds.

Using a hypothetical liquidation year of 2005, Cobb estimated the value of JMHI's assets including, among other things, payments that JMHI would receive from INOVA pursuant to the 1994 INOVA Agreement. Cobb estimated that a liquidation of JMHI's business in September 2005 would result in net proceeds of about $21,944,511. He estimated that the "present value" of this amount in December 1999 was between $4,646,000 and $10,347,000, depending on various annual rates of return. However, Cobb did not include in his calculations the $10 million payment due from INOVA on October 1, 2005.

Tauber testified concerning the buildings and building additions built by the partnerships KSJV, JMHA, and JMHJV. His testimony primarily addressed the cost, rather than the source of the funds used, for the improvements constructed. He stated that construction of the original hospital building was completed in 1965 at a cost of $1,055,000, and that a "nursing wing" was built in 1968 at a cost of about $110,000.

Tauber testified that a foyer, corridor, and physical therapy unit were added to the hospital in 1974 at a cost of

about $96,000, and that an intensive care unit was added in the late 1970's at an approximate cost of $92,000. He also stated that in 1979, a six-story office building was built on King Street (the Medical Office Building) at a cost of about $2,650,000.

Tauber testified that "the physicians" paid $1,600,000 of the construction costs of the Medical Office Building, but he did not identify more specifically who actually made these contributions. He indicated that the remaining costs of that building were financed from the $1,400,000 "new mortgage" that was assumed by JMHC in 1978. He also testified that another office building was constructed in 1982 on North Beauregard Street (the Beauregard Building) at an approximate cost of $722,000.

Tauber stated that as part of an effort to attract doctors to the Beauregard Building, JMHJV leased two-thirds of the building's office space to Irwin S. Freedman, one of the defendants, and his medical practice group. Freedman's lease was for a term of ten years and provided that at its termination, Freedman could purchase the portion of the building he occupied for $1, conditioned on his group practice having admitted at least 90% of its patients to the hospital. Eight and one-half years into the lease term, Freedman was permitted to purchase this two-thirds ownership share of the Beauregard Building for $1.

Tauber further testified that in 1983 a fourth-floor addition was built over the nursing wing of the hospital at a cost of approximately $927,000. Finally, he agreed that the hospital building would be a mere "white elephant" without the license to operate the hospital because the building was "a single-purpose building."

## III. CHANCELLOR'S DECISION

In a letter opinion dated July 13, 2000, the chancellor rejected the defendants' accounting. He observed that the

methodology used by the defendants did not afford "an opportunity to calculate the receipts, disbursements, rents, and profits that actually accrued to [the defendants]." The chancellor also found, in relevant part:

> [The defendants] obtained interests in real property, were paid "dividends" in excess of their capital contributions, and finally obtained a settlement of a dispute with Inova directly arising out of hospital operations.
>
> Under accepted principles, [the defendants] cannot profit from the wrong doing found by the Court and must be called to account for the profit obtained. In addition, where [the defendants], trustees in dissolution, commingle their interests with those of the charity, they bear the burden of proving the separate nature of the assets. [The defendants] have not met that burden. Hence, they are accountable for all of the assets, rents, profits, and receipts they obtained.

The chancellor determined that JMHI's interest in the real property and improvements included a 70% interest in Hopkins Parcels 1 and 2, a 100% interest in the Berman parcel, which he referred to as "Beauregard Street," and a 100% interest in the hospital improvements and the Beauregard Building. He concluded that the Commonwealth's accounting established that the defendants received net revenue through June 30, 1999 in the amount of $26,372,438. The chancellor also determined from the Commonwealth's accounting that the anticipated revenue from the 1994 INOVA Agreement through October 1, 2005, including the $10 million payment, was $24,703,145. These figures resulted in total net and future revenue in the amount of $51,075,583.

The chancellor's ruling further provided, in relevant part:

> Under strict accounting rules, [the defendants] would be liable for the accrued revenues plus the present value of the future payments due from Inova. However, equitable principles require that a fairness test be applied to any award in this case.
>
> Since [the defendants] now hold valuable real estates as trustees in dissolution, and since the benefit to other charities will be substantial even if [the defendants] are not required to account dollar-for-dollar, and the purposes of this cause will be served, this Court finds that an award of Twenty Million Dollars ($20,000,000.00) in addition to the real property is fair and just under all of the circumstances.

The chancellor also stated that he would consider further argument whether the defendants were entitled to a credit for "costs of acquisition and improvements to the realty actually incurred."

On November 13, 2000, a hearing was held in which the defendants presented evidence that Leslie P. Gondor, M.D., one of the defendants, paid $150,000 in 1964 to purchase an interest in certain real property from JMHI. Gondor made this purported purchase in his own name by means of an "off-record" letter transaction. At the same hearing, the defendants argued, among other things, that they should be given a credit for the construction costs of the hospital building, the Medical Office Building, and the Beauregard Building.

In a letter opinion dated December 27, 2000, the chancellor denied the defendants' motion for acquisition and construction credits and their motion to release portions of the award to certain charities controlled by Tauber. The chancellor also denied the Commonwealth's motion for an award of attorneys' fees and costs.

On February 21, 2001, the chancellor entered a decree incorporating his previous letter opinions and awarding judgment in favor of the Commonwealth as trustee against the defendants "individually and as former directors and/or trustees and/or trustees in liquidation," and against JMHA, JMHJV, JCA, and Tauber as trustee and agent for JMHA and JMHJV. The chancellor further decreed "that all of the assets referenced and described herein are subject to [the] constructive trust," including the anticipated revenue from the 1994 INOVA Agreement.

The chancellor's decree directed that the assets subject to the constructive trust be distributed according to the doctrine of cy pres. In his decree, the chancellor also provided for interest on his award at the statutory rate of nine percent from July 13, 2000, the date the chancellor issued his opinion letter deciding the case in favor of the Commonwealth.

The chancellor later held a hearing to set the amount of an appeal bond. He ruled that under Code § 8.01-676.1(C), he was obligated to "require the posting of an appeal bond . . . with surety or an irrevocable letter of credit in an amount sufficient to pay [the] judgment."

The defendants appealed from the chancellor's holdings. The Commonwealth assigned cross-error to the amount of the judgment and the chancellor's refusal to award the Commonwealth its attorneys' fees and accounting costs.

## IV. ISSUES RESOLVED BY TAUBER I

The defendants raise several arguments that we resolved in Tauber I or are necessarily decided by our holdings in that appeal. We will set forth these issues below.

### Void Transactions and "Fairness"

The defendants argue that the chancellor erred in failing to hold that the purported sale in 1975 of JMHI's

assets to JMHC, or in the alternative, the 1982 transactions with HGV, constituted acts of trustees in dissolution of JMHI to "wind-up" the non-profit corporation. The defendants also assert that the chancellor erred when he held that the purported sale in 1975 of JMHI's assets to JMHC was void, regardless of the fairness of the sale from the perspective of JMHI. We disagree with the defendants' arguments.

In Tauber I, we concluded that the law and the evidence fully supported the chancellor's rulings that JMHI and JMHC did not "merge" in 1971. Id. at 455, 499 S.E.2d at 844. We also held that the transactions purportedly taken by the directors after the 1973 charter revocation were void. We stated:

> Because the 1971 "transaction" never occurred, the 1973 revocation of JMHI's corporate charter converted its directors by operation of law to trustees in dissolution . . . .
>
> The charter revocation terminated JMHI's corporate existence and powers, and it could no longer function as a corporation. . . . From that day forward, the defendants' actions purportedly taken as corporate officers, and not done to wind up or liquidate the business, were without effect because there was no corporation for which to act. The corporate assets had automatically transferred to the directors as trustees.

Id., 499 S.E.2d at 844-45.

In addition, as stated above, we concluded that the "record clearly demonstrates that the directors of JMHI, now trustees in dissolution, have failed and refused to execute the trust." Id. at 456, 499 S.E.2d at 845. We held that the transactions at issue showed "an entire course of self-dealing by the directors of the charity" that resulted in "the total

obliteration of the non-profit corporation [JMHI]." Id. at 453-54, 499 S.E.2d at 844.

These holdings in Tauber I mandate our present conclusion that the purported sale in 1975 of JMHI's assets to JMHC, and the 1982 transactions with HGV, did not constitute acts of the defendants as trustees in dissolution to "wind-up" the corporate affairs of JMHI. This conclusion is amply supported by the record, which contains no indication that the transactions in 1975 and 1982 were entered into by the defendants as trustees in dissolution of JMHI, on behalf of the charity, rather than as directors of JMHC who profited from the transactions.

In Tauber I, we also rejected the defendants' contention that we should apply a "fairness" test to the 1971 failed "merger" between JMHI and JMHC. Id. at 455-56, 499 S.E.2d at 845. Our conclusion was based on our holding that the defendants were not entitled under any circumstances to property rights or other assets belonging to JMHI, either during or after the life span of the corporation. We stated that "[t]o hold otherwise would convert the public nature and purpose of the corporation into a vehicle for the personal pecuniary gain of the members." Id. at 455, 499 S.E.2d at 845 (quoting Hanshaw v. Day, 202 Va. 818, 824, 120 S.E.2d 460, 464 (1961)). This conclusion applies equally to the purported sale in 1975. Moreover, a defense of "fairness" is inapplicable to the review of a void transaction such as the 1975 purported sale, because that transaction in effect never occurred.

Assets in Dissolution of JMHI

The defendants argue that the chancellor erred in classifying the rents, profits, and other sums accruing to entities controlled by the defendants, including revenues from the leases with HGV and INOVA and proceeds from the 1994 INOVA Agreement, as assets in dissolution of JMHI subject to the constructive trust. However, as stated

above, we concluded in Tauber I that after JMHI's charter revocation, its corporate assets were automatically transferred to the directors as trustees in dissolution of the charity. Id. at 455, 499 S.E.2d at 844-45. The evidence before the chancellor in the first proceeding, and Wilson's accounting testimony in the proceeding on remand, identified the leases with HGV and INOVA, and the proceeds of the 1994 INOVA Agreement, as assets of JMHI that were diverted by the defendants for their personal benefit to JMHJV.

We also find no merit in the defendants' argument that the chancellor erred in including in the constructive trust a parcel of land that JMHI purportedly had transferred to Gondor in the 1964 "off-record" transaction. The chancellor's holding is supported by Vella's testimony in the initial proceeding that JMHI presently is the beneficial owner of certain real property that includes the interest allegedly transferred to Gondor. Therefore, we conclude that the chancellor properly placed the above assets and property in the constructive trust.

"Sale" of Beauregard Building

The defendants contend that the chancellor erred when he held that the Beauregard Building was an asset in dissolution of JMHI. They contend that this building was sold to Freedman, one of JMHI's trustees in dissolution, and other bona fide purchasers for value who lacked notice of "any adverse claim" regarding the property. The defendants further contend that the imposition of a constructive trust on this property violated the Due Process Clause of the United States Constitution. We disagree with the defendants' arguments.

In Tauber I, we held that the trustees in dissolution of JMHI were not entitled to any of the charity's assets after the dissolution of the charity. Id. at 455, 499 S.E.2d at 845. However, Freedman purportedly purchased his two-thirds

interest in the Beauregard Building for $1 in 1992, during his tenure as a trustee in dissolution of JMHI. He entered into this purported transaction about 19 years after JMHI's charter revocation.

A purchaser of real property is bound by both constructive and actual notice and "has no right to shut his eyes or his ears to the inlet of information, and then say he is a bona fide purchaser [for value] without notice." Richmond v. Hall, 251 Va. 151, 157, 466 S.E.2d 103, 106 (1996) (quoting Burwell v. Fauber, 62 Va. (21 Gratt.) 446, 463 (1871)). Thus, we conclude that Freedman was not a bona fide purchaser for value without notice because at the time of his alleged purchase, he had actual notice that the charity had been dissolved and constructive notice that the Beauregard Building was one of the charity's assets.[1]

"Safe Harbor" Defenses

The defendants assert that the chancellor "failed to apply the law in effect at the time [he] rendered [his] decision," and that his "failure to apply Maryland law violated the Full Faith and Credit, Due Process, and Commerce Clauses of the United States Constitution." In support of these arguments, the defendants note that Maryland law provides a "safe harbor" for corporate directors who act in good faith in discharging their corporate duties.[2] The defendants also argue that the chancellor should have conducted a hearing concerning whether they took their actions as corporate officers in good faith.

These arguments are completely precluded by our holding in Tauber I that the defendants were trustees in dissolution of JMHI, rather than corporate directors,

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[1] We do not address the status of the other purported purchasers of the Beauregard Building because they are not parties to this suit.

[2] See Md. Code Ann., Corps. & Ass'ns § 2-405.1 (2001).

following JMHI's charter revocation in 1973. Id. at 455, 499 S.E.2d at 844. Therefore, any defenses of good faith in the exercise of business judgment that may be asserted by corporate directors of a non-profit corporation are inapposite here. See Code § 13.1-870; Lake Monticello Owners' Ass'n v. Lake, 250 Va. 565, 571, 463 S.E.2d 652, 656 (1995). See also Md. Code Ann., Corps. & Ass'ns § 2-405.1 (2001); Werbowsky v. Collomb, 766 A.2d 123, 138 (Md. 2001).

Doctrine of Cy Pres

The defendants assign error to the chancellor's decision to apply the Virginia law of cy pres rather than Maryland law governing the distribution of assets of a Maryland non-profit corporation. The common law doctrine of cy pres permits a court of equity to administer a charitable trust to conform as closely as possible to the purpose for which the trust was created or, if that purpose cannot be achieved, for some other charitable purpose.[3] See Baliles v. Miller, 231 Va. 48, 56 n.7, 340 S.E.2d 805, 810 n.7 (1986); Campbell v. Board of Trustees, 220 Va. 516, 524, 260 S.E.2d 204, 209 (1979).

In Tauber I, we held that the chancellor properly imposed a constructive trust so that the assets of JMHI can be distributed in accordance with appropriate charitable purposes. We stated that

> the [chancellor] properly exercised [his] authority to insure that these assets, now held by the defendants as trustees in liquidation, are distributed in accord with the charitable purposes to which they should have been devoted. This power to liquidate the assets and business of a nonstock corporation may be exercised over the property within the court's

[3] We note that Code § 55-31, the "cy pres" statute, is inapplicable here because its provisions are confined to express trusts.

jurisdiction "of a foreign corporation that has ceased to exist." Code § 13.1-909(B).

Id. at 456, 499 S.E.2d at 845. Based on this holding in Tauber I, we conclude that the chancellor properly invoked the doctrine of cy pres in providing for the future distribution of JMHI's assets.

Individual Liability

The defendants argue that the chancellor erred in holding them individually liable for the amount of the assets diverted from the charity. The defendants also assert that they were entitled to notice and a hearing on the issue of individual liability under Virginia Code § 13.1-870, Md. Code Ann., Corps. & Ass'ns § 2-405 (2001), and the Due Process Clause of the United States Constitution.

These arguments, however, are precluded by our decision in Tauber I. In the amended bill of complaint in the original proceedings, the Commonwealth asserted, among other things, that the defendants were liable for the acts complained of "each individually and as a former director of [JMHI] ... and/or as partners in Jefferson Memorial Hospital Associates, or [JMHJV], and/or directors or shareholders of [JMHC] (a Delaware Corporation now known as 'Jefferson Corporation of Alexandria')." Id. at 449, 499 S.E.2d at 841.

The chancellor held that the Commonwealth was entitled to the relief requested in its amended bill of complaint, and we upheld the chancellor's determination, without exception. Id. at 450, 456, 499 S.E.2d at 842, 845. This disposition in Tauber I resolved the issue of the defendants' individual liability, and their liability for their actions on behalf of JMHI, JMHC, JCA, JMHA, and JMHJV.

V. ISSUES NOT RESOLVED BY TAUBER I

We turn now to consider the defendants' assignments of error that are not precluded by our decision in Tauber I. After that discussion, we will examine the Commonwealth's assignments of cross-error.

Burden of Proof on Remand

The defendants argue that the Commonwealth had the burden of tracing JMHI's assets into an identifiable account or property. They assert that as a claimant seeking recovery of assets that may have been commingled with other assets, the Commonwealth must identify the portion of the commingled property to which it is entitled. In response, the Commonwealth contends that when trustees have commingled personal assets with those belonging to the trust, the entire commingled fund is subject to the constructive trust unless the trustees can distinguish the funds to which they personally are entitled.

In stating the burden of proof applicable to these proceedings, we first observe that a constructive trust arises by operation of law to prevent what otherwise would result in a fraud. See Crestar Bank v. Williams, 250 Va. 198, 204, 462 S.E.2d 333, 335 (1995); Leonard v. Counts, 221 Va. 582, 589, 272 S.E.2d 190, 195 (1980). The chancellor's imposition of a constructive trust, which we approved in Tauber I, reflected his determination that the defendants had wrongfully diverted the assets of JMHI into other entities and business opportunities for their personal benefit.

On remand, the chancellor was required to fix the amount of JMHI's assets held by the defendants as trustees in dissolution of the charity. As the successful proponent of the constructive trust, the Commonwealth bore the initial burden on remand of tracing JMHI's assets and establishing the amount of its intangible assets. See Crestar Bank, 250 Va. at 204, 462 S.E.2d at 335-36; Watts v. Newbury, 107 Va. 233, 240, 57 S.E. 657, 659 (1907). However, to the extent that the defendants commingled their own property with JMHI's

assets and sought recovery of such property, they had the burden of proving how much of the commingled funds they owned personally. See Brown v. Coleman, 566 A.2d 1091, 1097 n.7 (Md. 1989); Bass v. Smith, 56 A.2d 800, 805 (Md. 1948); MacBryde v. Burnett, 132 F.2d 898, 900 (4th Cir. 1942); V Austin W. Scott & William F. Fratcher, The Law of Trusts § 515, at 609 (4th ed. 1989). The defendants bore this evidentiary burden because when trustees conduct their affairs in a manner that prevents a precise accounting of trust assets, the trustees, rather than the trust, must suffer the consequences. Am. Nat'l Bank v. Ames, 169 Va. 711, 750, 194 S.E. 784, 798 (1938); see Royall v. Peters, 180 Va. 178, 189, 21 S.E.2d 782, 787 (1942); First Nat'l Bank v. Commercial Bank & Trust Co., 163 Va. 162, 175, 175 S.E. 775, 779 (1934).

Evidence Tracing JMHI's Assets

The defendants argue that the Commonwealth's accounting, on which the chancellor relied, was "flawed" and did not account for the "separate income" attributable to JMHC and JMHJV. They also contend that JMHI did not have an ownership interest in the hospital or in its underlying land, and that the Commonwealth failed to trace JMHI's assets into the Beauregard Building, the HGV lease, and the INOVA transactions. The defendants also assert that the chancellor erred in rejecting their accounting, which they claim properly identified their separate personal assets.

In response, the Commonwealth argues that its evidence was sufficient to meet its burden of tracing JMHI's assets and of establishing the amount of its intangible assets. We agree with the Commonwealth.

We consider the parties' arguments in the context of the chancellor's March 1997 order, which provided the framework for his determination of the amount of JMHI's assets. As stated above, in that order the chancellor directed the defendants to submit "a full and complete accounting of

all [JMHI's] assets and liabilities that . . . shall disclose all rents, issues, profits, accretions, and benefits, tangible and intangible, which have accrued therefrom."

In response to the chancellor's directive, the defendants submitted Cobb's accounting, which did not satisfy these requirements identified by the chancellor. Instead, Cobb attempted to place a value on the charity through the use of hypothetical dissolution dates of 1975, 1982, 1992, and 2005. This methodology was a complete departure from that used by the Commonwealth's accountant, Wilson, who structured his accounting of JMHI's assets in accordance with the requirements stated in the chancellor's decree.

The chancellor's decision to reject Cobb's approach was supported by Wilson's testimony. Wilson explained that Cobb's approach was not a fiduciary accounting because Cobb did not attempt to determine what actually had occurred with regard to JMHI's assets and liabilities, but merely made estimations regarding JMHI's value on certain dates. Wilson indicated that the use of this approach was unsound because JMHI was never liquidated and, thus, any valuation information was merely hypothetical in nature. Based on this evidence, we conclude that the chancellor did not err in rejecting Cobb's valuation approach.

We also hold that the chancellor did not err in accepting the Commonwealth's evidence tracing JMHI's assets. First, Vella's testimony supported the chancellor's award of the real property, including the improvements, to the Commonwealth. Vella, an expert in real property and title issues, stated that JMHI owned the Berman Parcel, which was also known as the Beauregard Street Parcel. In addition, she stated that JMHI owned a 65% undivided interest in the entire portion of land comprising Hopkins Parcels 1 and 2, as well as a parcel of land that overlapped Hopkins Parcels 1 and 2. Vella also testified that JMHI owned the beneficial interest in the hospital building and also

owned all structures and improvements built on Hopkins Parcels 1 and 2 and the Berman Parcel. These buildings included the Beauregard Building, which was built partly on the Berman Parcel.

Second, Wilson's accounting testimony and supporting documentary evidence satisfied the Commonwealth's burden of tracing JMHI's other assets. This evidence established that the primary value of the hospital derived from its operating license, which Wilson described as the "engine" that propelled the charity. Wilson testified that because the hospital operated as a "going concern" until the time of the 1994 INOVA Agreement, the hospital license generated many financial opportunities that Wilson identified as belonging to JMHI, rather than to the defendants and their "for-profit" entities. These opportunities included the 1982 HGV lease and the INOVA transactions.

As stated above, Wilson determined that the value of JMHI's assets, excluding the real property and improvements, subject to the constructive trust totaled $26,372,438 as of June 30, 1999. He also concluded that an additional $24,703,145 will accrue to the benefit of the constructive trust under the terms of the 1994 INOVA Agreement. Thus, we conclude that the evidence accepted by the chancellor adequately traced JMHI's assets, including the amount of its intangible assets.

Acquisition and Construction Costs

The defendants argue that the chancellor erred in denying them credit for acquisition and construction costs relating to JMHI's assets that were subject to the constructive trust. They assert that they are entitled to a credit for "sums advanced in transactions declared void by the Commonwealth," and for the purchase price paid by Gondor for the above-described interest in property he purportedly purchased in his own name. We disagree with the defendants' arguments.

In the chancellor's July 13, 2000 letter opinion awarding judgment in favor of the Commonwealth, he directed the parties to schedule a hearing for the determination, among other things, of any credit due to the defendants for acquisition costs. The chancellor also stated that he would consider whether the defendants were entitled to a credit for "improvements to the realty actually incurred." At a hearing in November 2000, the defendants did not present any testimony but argued from the evidence already presented that the costs expended in acquiring the properties and in building the improvements should be credited to them.

After considering the parties' arguments, the chancellor denied the defendants' request for such credits. We hold that the record supports the chancellor's decision. The defendants did not meet their burden of proving that their personal funds, rather than funds received from the operation of the hospital or from some other source, were spent to acquire property in JMHI's name or to construct improvements on property already owned by JMHI.

We also observe that the balance of the record fails to support the defendants' request for cost credits. Most notably, as stated above, the evidence showed that they diverted about $51 million of the charity's present and future assets into the "for-profit" entities in which they participated. They also received funds from the redemption of shares initially conveyed to them by JMHC in 1971 at the time of the failed "merger." The record shows that the defendants obtained at least $508,000 in these redemption transactions. Finally, the defendants' accountant, Cobb, acknowledged that the defendants made only one capital contribution to JMHI, which was repaid to them within two years.

Donations to Other Charities

We also find no merit in the defendants' argument that the chancellor improperly included in his award assets

purportedly transferred by JMHJV to two charities, which are controlled by Tauber as trustee. These alleged donations were made after JMHI's dissolution, and the defendants failed to prove that the "donations" were made from their own personal funds, rather than from the assets of JMHI that were subject to the constructive trust.

Prejudgment Interest

The defendants argue that the chancellor erred in calculating the award of interest from the date he issued his July 13, 2000 letter opinion rather than from February 21, 2001, the date of his decree awarding the $20 million judgment to the Commonwealth. Citing Code § 8.01-382, the defendants assert that interest may be awarded only from the date of entry of a judgment or decree. We disagree with the defendants' argument.

We consider the language of Code § 8.01-382 in accordance with its plain meaning. See Vaughn, Inc. v. Beck, 262 Va. 673, 677, 554 S.E.2d 88, 90 (2001); Cummings v. Fulghum, 261 Va. 73, 77, 540 S.E.2d 494, 496 (2001). This statute provides, in relevant part, that when an action or a suit is heard by the court without a jury, the court "may provide for interest on any principal sum awarded, or any part thereof, and fix the period at which the interest shall commence."

The plain language of Code § 8.01-382 gave the chancellor discretionary authority to determine whether the Commonwealth was entitled to prejudgment interest and to fix the date from which such interest was due. The chancellor's decision awarding interest on the monetary portion of the judgment from July 13, 2000 effectively provided prejudgment interest at the statutory rate between July 13, 2000 and the date of the chancellor's decree, February 21, 2001. We conclude that based on the extended duration of this suit, and the overwhelming evidence in the record against the defendants, the chancellor's decision to

award interest from July 13, 2000 was not an abuse of his discretionary authority under the statute.

Appeal Bond

Finally, the defendants argue that the chancellor erred in ruling that Code § 8.01-676.1(C) provides the sole method by which a court may suspend execution of a decree pending appeal. The defendants assert that this statute does not limit the chancellor's "inherent authority" to set a bond in an amount less than the judgment to stay execution of a decree. We disagree with the defendants' arguments.

The plain language of the statute governs our analysis. See Vaughn, 262 Va. at 677, 554 S.E.2d at 90; Cummings, 261 Va. at 77, 540 S.E.2d at 496. In relevant part, Code § 8.01-676.1(C) provides that an appealing party who requests a suspension of execution of a judgment during an appeal "shall . . . file an appeal bond or irrevocable letter of credit conditioned upon the performance or satisfaction of the judgment and payment of all damages incurred in consequence of such suspension, and . . . execution shall be suspended upon the filing of such security and the timely prosecution of such appeal."

This statutory language does not give the trial court discretion to set an appeal bond in an amount less than the judgment. The purpose of the statute is to secure payment of the full judgment amount and all damages incurred as a result of the suspension of execution of the court's decree. A lesser amount would undermine the security of the judgment to which a prevailing party is entitled in the event that an appellant does not succeed on appeal. Thus, we hold that the chancellor did not err in requiring the defendants to post an appeal bond in conformance with the mandatory terms of the statute.

Amount of Judgment

Asserting cross-error, the Commonwealth contends that the chancellor erred in failing to award the Commonwealth the full amount of diverted assets identified by Wilson in the amount of about $51 million. The Commonwealth contends that it is entitled to that amount, rather than the $20 million amount awarded by the chancellor, based on the evidence presented and the defendants' failure to meet their burden of proving any separate sums to which they were entitled. Thus, the Commonwealth argues that the chancellor improperly reduced the award from the total sum that he determined the defendants would have been liable to pay under "strict accounting rules." In response, the defendants ask us to reject the Commonwealth's argument, asserting that the chancellor failed to make any findings supporting such an award to the Commonwealth.

In resolving this issue, we first observe that the chancellor accepted the Commonwealth's accounting but cited general principles of "equity and fairness" in support of his decision reducing the amount of the award. He also noted the fact that JMHI's property included valuable real estate, and that "the benefit to other charities will be substantial even if [the defendants] are not required to account dollar-for-dollar, and the purposes of this cause will be served." The chancellor entered judgment in the reduced amount after finding that the Commonwealth had proved that the defendants diverted from JMHI the sum of $26,372,438 in present net revenues, and an additional sum of $24,703,145 in future net revenues, for a total lost revenue amount of $51,075,583.

We conclude that because the assets at issue were funds belonging to a charity, the chancellor erred in reducing the amount of the award from the sums established by the evidence he had approved. In effect, the chancellor's award permitted the defaulting trustees of JMHI to retain

significant assets of the charity that belong to the public. This result was erroneous. The defendants, as fiduciaries, were precluded from retaining any of these assets because they "acquired no property rights in, nor were they equitably entitled to such assets, either during the lifetime of the [non-profit] corporation or upon dissolution." Tauber I, 255 Va. at 455, 499 S.E.2d at 845 (quoting Hanshaw v. Day, 202 Va. 818, 824, 120 S.E.2d 460, 464 (1961)).

Attorneys' Fees and Costs

The Commonwealth also assigns cross-error to the chancellor's decision denying the Commonwealth attorneys' fees and costs, asserting that the fees were incurred because the defendants failed to execute their duties as trustees in dissolution and evaded their accounting obligations under the chancellor's March 1997 decree. The Commonwealth contends that an award of attorneys' fees would have been appropriate under our decision in Prospect Development Company v. Bershader, 258 Va. 75, 515 S.E.2d 291 (1999), and that an award of costs should have been made under Code § 26-23.

Upon consideration of these arguments, we conclude that the chancellor did not abuse his discretion in failing to award attorneys' fees and costs. In Bershader, a fraud suit, we approved a chancellor's award of attorneys' fees when the evidence showed that the defendants engaged in "callous, deliberate, deceitful acts," which caused the plaintiffs to incur over $150,000 in attorneys' fees. Id. at 92, 515 S.E.2d at 301. We acknowledged the discretionary nature of the chancellor's authority and held that he did not abuse that discretion based on the amount of effort required to protect the defrauded parties' rights. Id. at 92-93, 515 S.E.2d at 301.

Unlike Bershader, this case does not involve a review of an award of attorneys' fees, but concerns the chancellor's failure to award such fees. Thus, the Commonwealth effectively asks us to conclude that under the facts of this

case, the chancellor was required as a matter of law to award attorneys' fees to the Commonwealth. We decline to restrict the chancellor's discretion in this manner. Although the defendants engaged in a longstanding course of self-dealing at the expense of JMHI, which would have supported an award of attorneys' fees under the evidence presented, we cannot say that the chancellor lacked the discretion to deny attorneys' fees after considering the other relief awarded.

We also disagree with the Commonwealth's contention that the chancellor erred in failing to award the Commonwealth its costs under Code § 26-23 for the preparation of its accounting. Code § 26-23 provides:

> The costs of all proceedings against fiduciaries failing, without good cause, to make the returns and exhibits required, shall be paid by them personally, and they shall receive no allowance for the same in the settlement of their accounts.

This statute is limited to an award of costs related to proceedings instituted against fiduciaries who fail to make returns required by statute in performance of their duties in a chancery case. Thus, this provision has no application to the present case and did not provide the trial court the authority to award the Commonwealth its expert witness fees for its accounting.

Finally, we have considered, and reject, the other arguments presented by the defendants in this appeal.

## VI. CONCLUSION

For these reasons, we will reverse the monetary portion of the chancellor's award and enter final judgment for the Commonwealth as trustee in the amount of $26,372,438, with interest from July 13, 2000 at the judgment rate fixed by Code § 6.1-330.54. We will affirm the chancellor's judgment in all other respects, including the real estate interests awarded to the Commonwealth as trustee.

We will remand the case to the chancellor for execution on the appeal bond, collection of the judgment, and for distribution of JMHI's current assets in accord, as nearly as possible, with the charitable purposes to which they should have been devoted. The constructive trust imposed by the chancellor on the proceeds due from the 1994 INOVA Agreement will continue for the duration of that Agreement for receipt of future net revenues due after June 30, 1999, in the amount of $24,703,145. Such sums will be paid when due into the Circuit Court for the City of Alexandria for distribution by the chancellor in accordance, as nearly as possible, with the charitable purposes to which they should have been devoted.

Affirmed in part and final judgment,

reversed in part, modified, and final judgment as modified, and remanded.

50201058

## APPENDIX B

VIRGINIA: IN THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA

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|---|---|
| COMMONWEALTH OF VIRGINIA, ex. rel., MARK EARLY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; MARK EARLEY, et al., | |
| Complainants, | Chancery No. 961241 |
| v. | |
| LASZLO N. TAUBER, ET AL., | |
| Respondents. | |
| INOVA HEALTH CARE SYSTEMS, et al., | |
| Complainants, | |
| v. | Chancery No. 970488 |
| COMMONWEALTH OF VIRGINIA, ex. rel., MARK EARLY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA, et al., | |
| Respondents. | |

DECREE

THIS MATTER came to be heard on Friday, March 23, 2001, upon Respondents' *Motion to Suspend Enforcement of Decree Pending Outcome of Appeal*, and Friday, April 20, 2001, upon Respondents' *Motion for Reconsideration of its Motion to Suspend Enforcement of Decree Pending Outcome or Appeal or in the Alternative, for Interim Stay of Enforcement Pending Review by Virginia Supreme Court.*

**IT APPEARING TO THE COURT** upon consideration of the memoranda and pleadings filed and oral argument by counsel at the March 23, 2001 hearing, that for the reasons stated from the Bench at the time of the March 23, 2001 and April 20. 2001 hearings, that:

**IT IS HEREBY ORDERED, ADJUDGED AND DECREED** as follows:

1. Respondents' *Motion for Reconsideration of its Motion to Suspend Enforcement of Decree Pending Outcome of Appeal or in the Alternative for Interim Stay of Enforcement Pending Review by Virginia Supreme Court* is DENIED and the Court will require that the additional $12 million be secured for purposes of appeal.

2. Any execution upon the February 21, 2001 Decree in this matter is hereby suspended for thirty days, until May 21, 2001, so as to provide Respondents in this matter with an opportunity to appeal this Court's ruling with respect to *Virginia Code* Section 8.01-676.1(C), and to allow the Supreme Court to review and decide whether or not the cash and supercedeas bond with surety rider currently on deposit with this Court which totals more than $8.5 million together with the continuing monthly deposit with the General Receiver of the Inova settlement payments of $177,083.33 per month constitute sufficient security for a stay of enforcement of this Court's February 21, 2001 decree pending appeal of that decree to the Virginia Supreme Court.

3. The existing supercedeas bond with surety rider and cash on deposit with this Court, as well as all future settlement payments which are to continue to be paid by Inova to the General Receiver, will remain on deposit with the Court until such time as an appropriate receiver is appointed by this Court and an appropriate plan of distribution has been adopted.

4. After the Supreme Court has decided whether this Court's February 21. 2001 decree is correct or not, and if a receiver is then appointed by this Court after the appeal is decided, the appointed receiver will handle proposing a plan of distribution, collection of the judgment, execution on the bond and all of those other matters.

ENTERED this 25 day of April, 2001.

/s/
Circuit Court Judge

SEEN AND ALL OBJECTIONS NOTED
AND PRESERVED FOR APPEAL:

[objections noted]
Marc E. Betties, Esq. (VAB # 06379)
Lawson & Frank, P.C.
6045 Wilson Boulevard, Suite 100
Arlington, Virginia 22205

Richard S. Schneider, Jr., Esq. (VAB # 34258)
Senior Assistant Attorney General
900 East Main Street
Richmond, VA 23219

COUNSEL FOR COMPLAINANTS

SEEN AND ALL OBJECTIONS NOTED
AND PRESERVED FOR APPEAL:

/s/
Gaspare J. Bono, Esq.
Cameron Chick, Esq. (VA Bar No. 40224)
Long Aldridge & Norman, LP
701 Pennsylvania Avenue, NW
Suite 600
Washington, D.C. 20004

[objections noted]
Philip J. Hirschkop, Esq.
Hirschkop & Associates
108 North Columbus Street
Alexandria, Virginia 22314

[objections noted]
Kevin M. O'Donnell, Esq.
Henry & O'Donnell, PC
4103 Chain Bridge Road
Suite 100
Fairfax, Virginia 22030

COUNSEL FOR RESPONDENTS

SEEN AND ALL OBJECTIONS NOTED
AND PRESERVED FOR APPEAL

[objections noted]
Anthony J. Trenga
Miller & Chevalier
655 Fifteenth Street, N.W.
Suite 900
Washington, DC 20005

COUNSEL FOR INOVA HEALTH CARE SYSTEM AND INOVA HEALTH SYSTEM FOUNDATION

**APPENDIX C**

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

Courthouse
520 King Street
Alexandria,
Virginia
22314-3164
(703)838-4123

April 25, 2001

Marc E. Bettius, Esquire
Ina C. Charvet, Esquire
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Richard S. Schweiker, Jr.,
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Senior Assistant Attorney
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Gaspare J. Bono, Esquire
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Washington. D.C. 20004

Anthony J. Trenga, Esquire
Miller & Chevalier
655 Fifteenth Street, NW,
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Philip J. Hirschkop, Esquire
Hirschkop & Associates
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Kevin M. O'Donnell,
Esquire
Henry & O'Donnell
4103 Chain Bridge Road,
Suite 100
Fairfax, VA 22030

David J. Kiyonaga, Esquire
526 King Street. Suite 213
Alexandria, VA 22314

Re: Commonwealth. *ex. rel.* v. Tauber, et al.
Chancery No. CH961241
Inova v. Tauber, et al.
Chancery No. CH970488

Dear Counsel,

Respondent's decree accurately reflects the rulings of the Court and I have entered their proposed decree.

I have noted on the decree the objections of all parties.

Very truly yours,

/s/

Alfred D. Swersky

Enclosure

## APPENDIX D

VIRGINIA: IN THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA

| | | |
|---|---|---|
| COMMONWEALTH OF VIRGINIA, *ex rel.* MARK L. EARLEY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; MARK L. EARLEY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; and THE COMMONWEALTH'S ATTORNEY FOR THE CITY OF ALEXANDRIA, | ) | CHANCERY NO. 961241 |
| Complainants, | ) | |
| v. | ) | |
| LASZLO N. TAUBER, et al., | ) | |
| Respondents. | ) | |
| INOVA HEALTH CARE SYSTEM, et al., | ) | |
| Complainants, | ) | |
| v. | ) | CHANCERY NO. 970488 |
| COMMONWEALTH OF VIRGINIA, *ex rel.* MARK L. EARLEY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA, et al. | ) | |
| Respondents. | ) | |

DECREE

THIS CAUSE came to be heard upon the merits at a trial commencing on February 1, 2000 until its conclusion; and

Pursuant to this Court's direction as more fully set forth in its July 13, 2000 Letter Opinion, a hearing was conducted on November 13, 2000 for the purpose of taking additional evidence and the presentation of argument by counsel; and upon testimony, exhibits and papers formally filed, the arguments of counsel, and the authorities submitted and considered, and for the reasons stated and fully set forth in the Court's Letter Opinions dated July 13, 2000, November 30, 2000, December 27, 2000, January 23, 2001 and February 5, 2001 which are hereby referenced and incorporated as if set forth in full, it is hereby:

ORDERED, ADJUDGED and DECREED that, pursuant to the herein referenced July 13, 2000 Letter Opinion, the December 27, 2000 Letter Opinion, and the February 5, 2001 Letter Opinion, the Commonwealth, as trustee, shall have judgment against and shall recover individually and jointly and severally from each of the Respondents named herein in Chancery No. 961241, to-wit: Laszlo N. Tauber, the Estate of Samuel Burtoff, Michael A. Corrado, Daniel J. Feriozi, Irwin S. Freedman, Leslie P. Gondor, Reginald P. McManus, Leslie L. Peters. Magdolna A. Iranyi and the Estate of James H. Scully, individually and as former directors and/or trustees and/or trustees in liquidation of Jefferson Memorial Hospital, Inc. and/or its successors in interest; and as directors and/or shareholders of Jefferson Memorial Hospital Corporation and/or Jefferson Corporation of Alexandria; and as partners in Jefferson Memorial Hospital Associates, a partnership and/or Jefferson Memorial Hospital Joint Venture, a partnership; and Jefferson Memorial Hospital Associates, a partnership,

Jefferson Memorial Hospital Joint Venture, a partnership and Jefferson Corporation of Alexandria; and Laszlo N. Tauber, also as trustee and agent for Jefferson Memorial Hospital Associates, a partnership, and Jefferson Memorial Hospital Joint Venture, a partnership; in the amount of TWENTY MILLION DOLLARS ($20,000,000) with interest from July 13, 2000 at the statutory judgment rate of interest which is currently nine percent (9%) per year; it is further

ORDERED, ADJUDGED and DECREED that the Commonwealth, as trustee, shall have judgment against, and shall recover from, the Respondents named herein in Chancery No. 961241, individually and jointly and severally, the real property and improvements delineated in the Court's July 13, 2000 Letter Opinion; it is further

ORDERED, ADJUDGED and DECREED that Respondents named herein in Chancery No. 961241 motion for credits for any claimed acquisition costs of the real estate and improvements is denied; it is further

ORDERED, ADJUDGED and DECREED that the Respondents named herein in Chancery No. 961241, individually and jointly and severally, are responsible for the appropriate execution and delivery of special warrant deeds for the real estate interests awarded herein to the Commonwealth, as trustee. Further, failing delivery of said deeds within twenty-one (21) days of entry of this Decree, a Special Commissioner to be determined later, shall be appointed by the Court to make and execute the appropriate deeds so as to effect the transfer of real property and improvements herein decreed; it is further

ORDERED, ADJUDGED and DECREED that, notwithstanding the Court's prior ruling set forth in the July 13, 2000 Letter Opinion, and pursuant to the Court's Letter Opinion dated November 30, 2000, the Respondents in Chancery No. 961241 will not be held personally liable for payment of the attorneys' fees of the Complainants in

Chancery No. 961241, but that special counsel will be awarded a fee for services based upon his contract with the Attorney General, with said fee to be paid from the fund created; it is further

ORDERED, ADJUDGED and DECREED that all of the assets referenced and described herein are subject to a constructive trust, including but not limited to any and all anticipated revenue from a certain Settlement Agreement dated July 11, 1994 between INOVA Health System Hospitals and Inova Health System Foundation and Laszlo N. Tauber, Trustee, and Jefferson Memorial Hospital Joint Venture (hereinafter referred to as the "INOVA Settlement") through October 1, 2005, including the $10,000,000 lump sum payment, and that said constructive trust shall remain in full force and effect until the judgments and the terms of this Decree are fully and completely satisfied and complied with by the Respondents named herein in Chancery No. 961241, including without limitation, payment of the award of attorneys' fees and expenses to the Complainants in Chancery No. 97048S (hereinafter referred to as the INOVA Complainants); it is further

ORDERED, ADJUDGED and DECREED that the INOVA Complainants shall continue to pay or cause to be paid into the registry of the Court, in care of the General Receiver of the Circuit Court for the City of Alexandria, or such other person or entity as this Court may subsequently direct, those amounts due and payable under the INOVA Settlement until such time as the amounts deposited therein are sufficient to satisfy completely the judgments entered herein, including, without limitation, any postjudgment interest that will accrue thereon and the amount of the INOVA Complainants' attorneys' fees and expenses awarded herein, or until such time as the judgments have otherwise been completely satisfied; that pursuant to *Virginia Code* Section 8.01-364 (C), 1950, as amended, the Respondents in

Chancery No. 970488, and their agents and employees and anyone acting in concert with or under their direction, are permanently restrained from instituting or prosecuting any proceeding in any court of this Commonwealth with respect to any payments made by the INOVA Complainants pursuant to this Decree; that upon payment into the registry of this Court or as otherwise directed by this Court, the INOVA Complainants are hereby discharged from any further liability to the Respondents in Chancery No. 970488, or any one of them with respect to the payments made pursuant to this Degree; it is further

ORDERED, ADJUDGED and DECREED that, notwithstanding the Court's prior ruling set forth in the July 13, 2000 Letter Opinion, and pursuant to its Letter Opinions dated December 27, 2000 and January 23, 2001, for purposes of the matter now before this Court, to-wit: Chancery No. 970488, the INOVA Complainants' attorneys' fees are fixed at Fifty Two Thousand Fifty-one Dollars ($52,051) and costs at Five Thousand Thirty-four Dollars ($5,034), which fees and costs shall be assessed equally between Complainants and Respondents in Chancery No. 961241, judgment for which be, and the same hereby is, entered against said Complainants and Respondents, with postjudgment interest as set by law, and with said fees and interest to be paid from the funds paid into Court without further liability on any party or to such other person or entity as this Court may direct pursuant to this Decree; and the General Receiver of this Court is hereby authorized and directed to make such distributions to the INOVA Complainants sufficient to satisfy the judgment and award of attorneys' fees herein out of funds currently on deposit or which shall be deposited into the General Registry of this Court in the future; it is further

ORDERED, ADJUDGED and DECREED that the Motions of The Tauber Foundation, the Laszlo N. Tauber, M.D. Charitable Remainder Unitrust for the Benefit of the

Neutrophil Research Fund, Inc., the Laszlo N. Tauber, M.D. Charitable Remainder Unitrust for the Benefit of the Holocaust Center of Northern California, Inc. (hereinafter non-party organizations) and Respondent Jefferson Memorial Hospital Joint Venture to preclude transfer of a portion of the real estate and improvements and to reduce the monetary award to the Commonwealth are hereby denied; it is further

ORDERED, ADJUDGED and DECREED that the Motion of The Tauber Foundation and Respondents to strike the testimony of Mr. Thomas Reed is denied; it is further

ORDERED, ADJUDGED and DECREED that in addition to the July 13, 2000, November 30, 2000, December 27, 2000, January 23, 2001 and February 5, 2001 Letter Opinions previously referenced and incorporated herein, the Court's Letter Opinion of February 7, 1997 and its March 7, 1997 Order and December 6, 2000 Decree, are hereby adopted, referenced and incorporated as if set forth in full; it is further

ORDERED, ADJUDGED and DECREED that. the judgments entered herein are final and this matter is now concluded except with regard to the execution of this Decree, as set forth herein; it is further

ORDERED, ADJUDGED and DECREED that all parties may immediately proceed with an appeal if so desired, pursuant to the applicable laws of the Commonwealth and the Rules of the Supreme Court of Virginia; it is further

ORDERED, ADJUDGED and DECREED that this matter shall be continued on the Court's docket to consider the appointment of a Special Receiver or Custodian, and for the adoption of a plan for the use and disposition of the assets of Jefferson Memorial Hospital, Inc., and its successors in interest, which are subject to the constructive

trust imposed herein, including the disposition of the real estate and the monetary assets of the trust; and it is further

ORDERED, ADJUDGED and DECREED that the distribution of the assets described herein and subject to the constructive trust imposed by this Court shall be in accord with and subject to Virginia *cy pres* rules and not Maryland's corporate dissolution statutes.

ENTERED this 21 day of February, 2001
/s/
Circuit Court Judge

SEEN AND OBJECTED TO: For the reasons set forth in the record of this case, including but not limited to the pleadings and papers formally filed herein by Complainants.

/s/
Marc E. Bettius (VSB # 06379)
Ina C. Charvet (VSB # 39969)
Debra Fitzgerald-O'Connell (VSB # 31778)
Lawson & Frank, P.C.
6045 Wilson Boulevard
Suite 100
Arlington, Virginia 22205
(703) 534-4800
Counsel for Commonwealth of Virginia

A COPY
TESTE:
/s/ Deputy Clerk

Richard S. Schweiker, Jr. (VSB # 34258)
Senior Assistant Attorney General
Office of the Attorney General
900 East Main Street
Richmond, Virginia 23219
(804)786-2116

Counsel of Record for the Commonwealth of Virginia

SEEN AND OBJECTED TO:

[see attached copy for signature]
Anthony J. Trenga
MILLER & CHEVALIER
655 Fifteenth Street, NW
Suite 900
Washington, DC 20005
Counsel for INOVA Health Care System and
INOVA Health System Foundation

SEEN AND OBJECTED TO:

/s/
Gaspare J. Bono
LONG, ALDRIDGE & NORMAN, L.L.P.
701 Pennsylvania Avenue, N.W.
Suite 600
Washington, DC 20004
Counsel for Respondents Jefferson Memorial Hospital Joint Venture, Jefferson Memorial Hospital Associates, Jefferson Memorial Hospital Corporation, Jefferson Corporation of Alexandria, Laszlo N. Tauber, Leslie L. Peters, Irwin S. Freedman

SEEN AND OBJECTED TO:

[objection of Respondent are noted counsel has failed to endorse this decree]
Philip J. Hirschkop
HIRSCHKOP & ASSOCIATES
108 North Columbus Street
Alexandria, Virginia 22314
Counsel for Respondents Jefferson Memorial Hospital

Joint Venture, Jefferson Memorial Hospital Associates. Jefferson Memorial Hospital Corporation, Jefferson Corporation of Alexandria, I.aszlo N. Tauber, Leslie L. Peters. Irwin S. Freedman

SEEN AND OBJECTED TO:

Stephen G. Cochran
The Jefferson Law Firm, PLC
7th Floor
McLean, Virginia 22101
Counsel for Respondents

SEEN AND OBJECTED TO:

[objections of Respondents are noted counsel has failed to endorse the decree]
Kevin M. O'Donnell
HENRY & O'DONNELL, PC
4103 Chain Bridge Road
Suite 100
Fairfax, Virginia 22030
Counsel for Respondents Michael A. Corrado, Daniel J. Feriozi, Leslie P. Gondor, Magdolna Iranyi, Reginald McManus, Estate of Samuel Burtoff

SEEN AND OBJECTED TO:

[objections of Respondent are noted counsel has failed to endorse the decree]
David J. Kiyonaga
526 King Street
Suite 213
Alexandria, Virginia 22314
Counsel for Respondent Estate of James H. Scully

## APPENDIX E

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

Courthouse
520 King Street
Alexandria,
Virginia
22314-3164
(703)838-4123

February 5, 2001

Marc E. Bettius, Esquire
Ina C. Charvet, Esquire
Lawson & Frank
6045 Wilson Boulevard,
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Arlington, VA 22205

Richard S. Schweiker, Jr.,
Esquire
Senior Assistant Attorney
General
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Richmond, VA 23219

Gaspare J. Bono, Esquire
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Washington, D.C. 20004

Anthony J. Trenga, Esquire
Miller & Chevalier
655 Fifteenth Street. NW,
Suite 900
Washington, D.C. 20005

Philip J. Hirschkop, Esquire
Hirschkop & Associates
108 North Columbus Street
Alexandria, VA 22314

Kevin M. O'Donnell, Esquire
Henry & O'Donnell
4103 Chain Bridge Road,
Suite 100
Fairfax, VA 22030

David J. Kiyonaga, Esquire
526 King Street, Suite 213
Alexandria, VA 22314

Re: Commonwealth. *ex. rel.* v. Tauber, et al.
Chancery No. CH961241
Inova v. Tauber, et al.
Chancery No. CH970488

Dear Counsel,

I have reviewed the proposed decree and the objections made. There are some revisions necessary to the decree proposed by the Complainant. I will deal with the objections as follows:

I believe the special warranty deed is the appropriate manner of conveyance of the realty.

A constructive trust will be imposed upon the anticipated revenues and the Respondents are individually, jointly, and severally liable.

Inova's counsel fees will be paid from the proceeds paid into Court without further liability on any party. Interest on the monetary portion of the judgment will be awarded from July 13, 200, at the statutory rate.

Respondents' requests to stay enforcement of the judgment so long as the Inova payments are being made will be denied. The Court would, however, request that Complainant take no immediate collection actions, as the Inova payments will continue to be received by the Court.

The Court finds that the distribution of the assets is governed by the rules of cy pres and not corporate dissolution, Respondents' request that the decree reflect that it is subject to Maryland's law of distribution will be denied.

While the Commonwealth will be the trustee for all of the assets, the question of who will eventually be the receiver for accumulation and distribution remains for decision by the Court.

Respondents will be allowed to remain in the case for purposes of input into the plan of distribution.

The decree proposed by Complainant is appropriate except for the following;

1. Page 3 - the third full paragraph should state that a special commissioner to be determined later shall be appointed.

2. Page 6 - the language barring Respondents from participating in further proceedings should be deleted.

3. Language should be included reflecting the Court's finding that the distribution is subject to the cy pres rules and not Maryland's corporate dissolution statutes.

I expect counsel to promptly prepare and circulate such a decree so that Respondents may note their respective objections. If I do not have the decree in hand by February 19, 2001, I will prepare and enter an appropriate decree.

Very truly yours,

/s/

Alfred D. Swersky

## APPENDIX F

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

Courthouse
520 King Street
Alexandria,
Virginia
22314-3164
(703)838-4123

January 23, 2001

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Alexandria, VA 22314

Barbara P. Beach, Esquire
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Alexandria, VA 22314

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Henry & O'Donnell
4103 Chain Bridge Road,
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Fairfax, VA 22030

David J. Kiyonaga, Esquire
526 King Street, Suite 213
Alexandria, VA 22314

Re: Commonwealth. *ex. rel.* v. Tauber, et al.
Chancery No. CH961241
Inova v. Tauber, et al.
Chancery No. CH970488

Dear Counsel,

In accordance with my ruling of December 27, 2000, the parties in CH961241 shall share equally the attorneys' fees to be paid to Complainant in CH970488.

The Court finds the attorneys' fees and costs submitted to be fair and reasonable and are fixed at Fifty Two Thousand Fifty-one Dollars ($52,051) for attorneys' fees and Five Thousand Thirty-four Dollars ($5,034) as costs.

In my December 27th letter, I urged counsel to prepare an appropriate decree embodying the most recent rulings of the Court. No Decree having been submitted, the Court will prepare and enter its own Decree unless counsel furnish one on or before February 5, 2001.

Very truly yours,

/s/

Alfred D. Swersky

## APPENDIX G

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

Courthouse
520 King Street
Alexandria,
Virginia
22314-3164
(703) 838-4123

December 27, 2000

Marc E. Bettius, Esquire
Ina C. Charvet, Esquire
Lawson & Frank
6045 Wilson Boulevard,
Suite 100
Arlington, VA 22205

Richard S. Schweiker, Jr.,
Esquire
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Miller & Chevalier
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Barbara P. Beach, Esquire
416 Prince Street
Alexandria, VA 22314

Kevin M. O'Donnell, Esquire
Henry & O'Donnell
4103 Chain Bridge Road,
Suite 100
Fairfax, VA 22030

David J. Kiyonaga, Esquire
526 King Street, Suite 213
Alexandria, VA 22314

Re: Commonwealth. *ex. rel.* v. Tauber, et al.
Chancery No. CH961241
Inova v. Tauber, et al.
Chancery No. CH970488

Dear Counsel,

Respondents' motions for acquisition credits against the award of the real estate will be denied. Likewise, Respondents' motion to release portions of the award to the charities will be denied. These issues were considered by the Court in arriving at its initial award of the assets subject to the constructive trust.

In view of this ruling, Respondents' motion to strike Mr. Reed's testimony will be denied.

In Chancery No. 970488, Inova's attorney's fees are assessed equally between Complainant and Respondents in this cause.

Mr. Trenga should submit the final amount to counsel for the parties. Any objections must be filed as to the amount within ten (10) days of the receipt of the final amount, and if necessary, a hearing scheduled.

Counsel for Complainant should prepare a decree embodying these rulings as well as the previous ruling denying Complainant's motion for attorney's fees. The decree should include the Court's award of the Twenty Million Dollars and the realty interests, noting objections of any party.

Once this decree is entered the Court will deal with the remaining issues of a receiver, the disposition of the real estate, and the disposition of the monetary assets of the trust, giving the parties an opportunity to appeal the award.

Very truly yours,

/s/

Alfred D Swersky

## APPENDIX H

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

Courthouse
520 King Street
Alexandria,
Virginia
22314-3164
(703)838-4123

November 30, 2000

Marc E. Bettius, Esquire
Ina C. Charvet, Esquire
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6045 Wilson Boulevard,
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Richard S. Schweiker, Jr.,
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Senior Assistant Attorney
General
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Kevin M. O'Donnell,
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Henry & O'Donnell
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Suite 100
Fairfax, VA 22030

David J. Kiyonaga, Esquire
526 King Street. Suite 213
Alexandria, VA 22314

Re: Commonwealth, *ex rel.* v. Tauber, et al.
Chancery No. CH961241

Dear Counsel,

Complainants' motion to award attorneys' fees and costs will be denied. Special counsel will be awarded a fee for services based upon his contract with the Attorney General; however, that fee will be paid from the fund created.

There is no contract nor statutory basis for an award of additional attorneys' fees against Respondents.

While there are some exceptions to the requirement that there be a contract or statutory basis for an additional award of attorneys' fees, the Court finds none are applicable. *See*, Gilmore v. Basic Industries. Inc., 233 Va. 485 (1987).

Complainants' claim that Title 26, Code of Virginia, §23 provides a statutory basis to award attorneys' fees and costs. They claim costs in excess of Six Hundred Thousand Dollars ($600,000.00). This argument is without merit. The statute provides:

> The costs of all proceedings against fiduciaries failing, without good cause, to make the returns and exhibits required, shall be paid by them personally, and they shall receive no allowance for the same in the settlement of their accounts.

This statute is silent as to attorneys' fees and the Court will not read into the plain language of the statute a legislative intent to authorize an award of fees. The word "costs" has been interpreted by the Supreme Court to be limited to those costs essential to the prosecution of the suit such as filing fees or charges for service of process. *See,* Advanced Marine Enterprises, Inc. v. PRC. Inc., 256 Va. 106 (1998), where the Court interpreted the legislature's use of the word "costs" in the civil conspiracy statute (Title 18.2, Code of Virginia, §499, *et seq.).*

All other matters remain under advisement including the revisiting of the award of the real estate; any credit

Respondents may be awarded for the costs of acquiring the real estate; the claim of The Tauber Foundation, *et al.* to release assets of charitable entities; and the assessment of fees for Inova Hospital's interpleader action. I will try to resolve these matters shortly on the pleadings filed.

Respondents' counsel should prepare an appropriate decree embodying the ruling on attorneys' fees and costs and note Complainants' objection.

Very truly yours,

Alfred D. Swersky

## APPENDIX I

# Circuit Court of Alexandria
# Virginia

Judges
DONALD M. HADDOCK
ALFRED D. SWERSKY
JOHN E. KLOCH

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520 King Street
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July 13, 2000

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Ina C. Charret, Esquire
Debra Fitzgerald O'Connell, Esquire
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The Jefferson Law Firm
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Suite 900
Washington, D. C. 20005

Alexandria, VA 22314

Philip J. Hirschkop, Esquire
Hirschkop & Associates
108 N. Columbus Street
Alexandria, VA 22314

Re: Commonwealth Ex Rel. Early v. Tauber, et al.
Chancery No. CH961241

Dear Counsel,

The accountings offered by Respondents are rejected. The hypothetical bases, assuming dissolutions in 1973, 1982, 1992, and 2005 and calculating a value based upon various returns on capital, does not afford the Court an opportunity to calculate the receipts, disbursements, rents, and profits that actually accrued to Respondents.

Respondents obtained interests in real property, were paid "dividends" in excess of their capital contributions, and finally obtained a settlement of a dispute with Inova directly arising out of hospital operations.

Under accepted principles, Respondents cannot profit from the wrong doing found by the Court and must be called to account for the profit obtained. In addition, where the Respondents, trustees in dissolution, comingle their interests with those of the charity, they bear the burden of proving the separate nature of the assets. Respondents have not met that burden. Hence, they are accountable for all of the assets, rents, profits, and receipts they obtained. Hanshaw v. Day 202 Va. 818 (1961).

*Real Property:*

The Court finds that interest held by Respondents in the realty as trustees in dissolution to be as follows:

1. Hopkins parcel 1 and 2: 70%.
2. Beauregard Street: 100%.

3. Hospital Improvements: 100%.
4. Beauregard and Building: 100%.

The Court will hear argument on whether or not Respondents are entitled to a credit for costs of acquisition and improvements to the realty actually incurred. In addition, argument will be allowed on whether or not Dr. Gondor is entitled to a personal credit of One Hundred Fifty Thousand Dollars ($150,000.00) for sums advanced by him as payment for a purported one-half held interest in the real property and the manner by which such credit could be given.

*Benefits and Payments to Respondents:*

Complainant's accounting reveals that Respondents received net revenue through June 30, 1999, in the amount of $26,372,438.00, and that anticipated revenue from the Inova settlement through October 1, 2005, is $24,703,145.00 (including the $10,000,000.00 payment).

Under strict accounting rules, Respondents would be liable for the accrued revenues plus the present value of the future payments due from Inova. However, equitable principles require that a fairness test be applied to any award in this case.

Since Respondents now hold valuable real estates as trustees in dissolution, and since the benefit to other charities will be substantial even if Respondents are not required to account dollar-for-dollar, and the purposes of this cause will be served, this Court finds that an award of Twenty Million Dollars ($20,000,000.00) in addition to the real property is fair and just under all of the circumstances. In addition, Respondents will be liable for Complainant's attorney's fees as well as those of Inova in the related matter.

Counsel shall promptly schedule a hearing on the following:

1. Presentation of orders.
2. Appointment of an appropriate receiver.
3. Attorney's fees.
4. Credits, if any, for real property acquisition.
5. Plans for the disbursement of funds acquired by the Receiver.

Very truly yours.

/s/

Alfred D. Swersky

## APPENDIX J

Supreme Court of the United States

Laszlo N. TAUBER, et al., petitioners,

v.

VIRGINIA, ex rel., Mark EARLEY, Attorney General of Virginia et al.

No. 98-394.

Nov. 2, 1998.

Case below, 255 Va. 445, 499 S.E.2d 839.

Petition for writ of certiorari to the Supreme Court of Virginia denied.

**APPENDIX K**

IN THE
SUPREME COURT OF VIRGINIA
CITY OF RICHMOND

---

Record No. 971155

Circuit Court No. CH961241

LASZLO N. TAUBER, *et al.*,
*Appellants*,

against

COMMONWEALTH OF VIRGINIA, ETC., *et al.*,
*Appellees*.

---

PETITION FOR REHEARING

June 5, 1998

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On consideration of the petition of the appellants and the letter in support thereof to set aside the judgment rendered herein on the 17th day of April, 1998 and grant a rehearing thereof, the prayer of the said petition is denied.

A Copy,
Teste:

/s/
David B. Beach
Clerk

## APPENDIX L

IN THE
SUPREME COURT OF VIRGINIA
CITY OF RICHMOND

---

Record No. 971155

LASZLO N. TAUBER, *et al.*

v.

COMMONWEALTH OF VIRGINIA, ETC., *et al.*

---

Present: All the Justices

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OPINION BY JUSTICE A. CHRISTIAN COMPTON

April 17, 1998

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In this chancery suit, the Attorney General of Virginia and a commonwealth's attorney jointly assert jurisdiction in the name of the Commonwealth over assets located in Virginia held by trustees in dissolution of a foreign charitable corporation. The trustees had been directors of the corporation, which operated a hospital in this State.

A brief summary of the relevant business activities of the hospital directors will set the stage for this discussion. Jefferson Memorial Hospital, Inc. (JMHI), was chartered originally as a for-profit, stock corporation in Maryland in 1963. In 1964, the corporation amended its charter to become a nonprofit, nonstock charitable entity; it began operations as an acute-care hospital in Alexandria on March 15, 1965.

In April 1969, the federal Internal Revenue Service began an investigation leading to revocation of JMHI's tax-exempt status, retroactive to November 1, 1965. In 1971, the corporation's directors attempted to "merge" JMHI into a for-profit Delaware corporation, Jefferson Memorial Hospital Corporation (JMHC). There was an effort to dissolve JMHI and to transfer its assets and liabilities to JMHC, of which JMHI's directors would serve as directors.

In April 1973, Maryland ordered JMHI's corporate charter forfeited "for failure to file the necessary corporate personal property report or failure to pay any late filing penalties due."

In 1974, the directors retained counsel "to represent the Hospital in looking after and insuring that the Hospital Corporate structure for the past, present, and for the immediate future, be handled so as to insure that everything is legally correct and in keeping with the best interest of the investors of the Hospital," according to JMHC's minutes. Counsel testified that he was "asked to rectify the problem that had arisen because a supposed merger in '71 had not been done."

Unaware that Maryland had revoked JMHI's charter, counsel had the directors declare JMHI insolvent and approve transfer of JMHI's assets to JMHC. In January 1975, JMHC's directors authorized purchase of the assets and assumption of the liabilities. The directors of JMHC, believing they had assembled all the assets of the former

charity into the for-profit corporation, agreed to transfer all JMHC's "assets" to appellant Laszlo N. Tauber as trustee for appellant Jefferson Memorial Hospital Joint Venture (JMHJV), a partnership in which those assets apparently still reside. The directors also agreed to lease back from the partnership the transferred assets.

In July 1996, the present suit was instituted by the Commonwealth of Virginia, *ex rel.* the Attorney General of Virginia and the Commonwealth's Attorney for the City of Alexandria. The defendants are Tauber and nine other named physicians, "each individually and as a former director of [JMHI] . . . and/or as partners, in Jefferson Memorial Hospital Associates, or [JMHJV], and/or directors or shareholders of [JMHC] (a Delaware corporation now known as 'Jefferson Corporation of Alexandria')"; Jefferson Memorial Hospital Associates; JMHJV; and Jefferson Corporation of Alexandria. A prior suit had been commenced by the Attorney General against the same defendants in April 1995, but was non-suited during trial.

In the present suit, the plaintiffs filed a 112-paragraph, 40-page, three-count bill of complaint. They alleged that funds and assets received by the defendants as directors and trustees of a charitable corporation "were misappropriated and diverted" contrary to law that requires such funds to be used only for charitable purposes, "and not for private inurement." The plaintiffs then recited in detail the defendants' alleged business activities in connection with the hospital.

In count one, the plaintiffs alleged the "purported merger between JMHI and JMHC in 1971 never took place," and the "subsequent purported transfers of the property of JMHI were likewise null and void." Asserting "JMHI was and is a non-stock foreign corporation whose assets are located in the Commonwealth" and are subject to the trial court's jurisdiction, the plaintiffs asked the court: to declare

"that the purposes for which JMHI was created have been frustrated and are no longer capable of being accomplished by virtue of" the defendants' conduct; to declare that legal title to JMHI's assets remain in JMHI; to order that an appropriate custodian gather the assets of the former JMHI and administer them under the court's supervision; to require that defendants account for the money or other value received in the transactions and that defendants be surcharged for the charitable assets they usurped in the amount of at least $40 million; and to enter judgment against defendants as a result of "their conversion, misappropriation, or appropriation of the charitable assets" described.

In count two, the plaintiffs sought similar relief and also asked the court "to impose a constructive trust upon the Hospital, its land, equipment and any other assets," as well as upon settlement proceeds being paid by an entity which, in 1985, negotiated with JMHJV to buy the right to operate the hospital and its assets as a going concern.

In count three, the plaintiffs asked the court to declare that "the corporate opportunities of JMHI have been usurped" by the defendants; that the defendants be required "to account for and disgorge all sums usurped;" that the court impress upon any future sums defendants may receive "an appropriate judgment or trust to secure the interests of the beneficiaries of JMHI, and, if necessary, to refer the matter to the Commissioner in Chancery for an appropriate accounting and charging order against JMHJV."

After the chancellor overruled their demurrer and plea in bar, defendants answered the bill of complaint. They generally denied the allegations, asserting the plaintiffs are not entitled to the relief prayed for, or to any other relief.

The cause was heard ore tenus in January 1997. The parties had stipulated that the trial in the present suit was to commence where the prior trial terminated, and that the

record of all proceedings in the prior suit is to be a part of the present record.

Following the trial, the chancellor filed a memorandum opinion ruling that the plaintiffs are entitled to relief sought in the bill of complaint. In a March 1997 decree, from which we awarded defendants this appeal, the court declared that the assets and liabilities of JMHI "be, reside and remain with [defendants] as trustees and further that a constructive trust be . . . imposed on such assets and liabilities."

The court also ordered that a custodian "be appointed with exclusive jurisdiction to hold and administer the said assets and liabilities." Additionally, the court ordered defendants to submit "a full and complete accounting of all assets and liabilities that are the subject of this Decree." Finally, the court denied the plaintiffs' "claim for monetary damages."

On appeal, defendants contend the trial court erred "when it concluded that the Attorney General has authority to bring this suit." The chancellor ruled "that the Attorney General has standing and authority to bring this action both at common law and pursuant to" Code § 13.1-909(B). The trial court is correct.

We need address only the common law. This Court long ago recognized the common law authority of the Attorney General to act on behalf of the public in matters involving charitable assets. *Clark v. Oliver*, 91 Va. 421, 427-28, 22 S.E. 175, 177 (1895). Indeed, this authority has received legislative recognition as recently as last year. During its 1997 session, the General Assembly granted the Attorney General additional specific powers with respect to the disposition of assets by nonprofit health care entities. Acts 1997, ch. 615. These powers were granted "in order that the Attorney General may exercise his common law and statutory authority over the activities of these organizations." Code § 55-532.

Next, defendants argue the chancellor erred in ruling that Code § 55-29 provides authority for the Commonwealth's Attorney of the City of Alexandria to be a proper party to the claims asserted. We disagree.

Code § 55-29 (1995 Repl. Vol.) provides, as pertinent:

> When any such gift, grant or will is recorded and no trustee has been appointed, or the trustee dies or refuses to act, the circuit court . . . of the city in which the trust subject or any part thereof is, in the case of a gift or grant, or in which the will is recorded, may, on motion of the attorney for the Commonwealth in such court (whose duty it shall be to make such motion), appoint one or more trustees to carry the same into execution. . . . In enforcing the execution of any such trust a suit may be maintained against the trustee in the name of the Commonwealth when there is no other party capable of prosecuting such suit. The term *'trustees'* as herein used shall be construed to mean the persons, or governing body, charged with the execution of the trust, whether designated as 'trustees,' or 'directors' or otherwise. . . ."

The phrase "any such gift, grant or will" refers to Code § 55-26.1, which provides, "Every gift . . . made hereafter for charitable purposes, whether made in any case to a body corporate or unincorporated . . . shall be as valid as if made to or for the benefit of a certain natural person. . . ."

The foregoing provisions are not limited to express trusts arising by virtue of written instruments, as defendants argue, but apply, as here, when the assets of JMHI passed automatically to its directors as formal trustees of the charitable organization in liquidation. Thus, the Commonwealth's Attorney is a proper party to this litigation.

Parenthetically, because the defendants seem to raise this issue on brief, we note that use of the word "recorded" in the first clause of the first sentence of § 55-29 refers to recorded wills, and not to any requirement that gifts or grants also be recorded. This is made clear later in the same sentence where there is specific reference to "in which the will is recorded."

Next, we shall turn to the merits. A detailed recitation of the evidence gleaned from this record would serve no useful purpose. On appeal, the defendants primarily seek to have us annul factual findings of the chancellor. The evidence, except for opinions of experts, was not in dispute; defendants urge us to invalidate the legitimate inferences drawn by the trial court from those proven facts. This tactic will not succeed upon appellate review.

The findings of a chancellor, hearing evidence ore tenus, carry the weight of a jury verdict. *Giannotti v. Hamway*, 239 Va. 14, 23, 387 S.E.2d 725, 730 (1990). A judgment based upon such findings will not be annulled on appeal "unless it appears from the evidence that such judgment is plainly wrong or without evidence to support it." Code § 8.01-680. And, the plaintiffs' burden is to prove these allegations by a preponderance of the evidence. *Baylor v. Beverly Book Co.*, 216 Va. 22, 24, 216 S.E.2d 18, 19 (1975).

Upon review we shall recite the facts, including the legitimate inferences flowing from those facts, in the light most favorable to the plaintiffs, who prevailed below. In the early 1960s, following acquisition of real estate by deed and lease by King Street Joint Venture, held by defendant Tauber as trustee, JHMI was formed to transact the business of operating a hospital. This Maryland corporation was authorized to do business in Virginia in 1963. Following the March 1965 opening, the hospital experienced "problem[s] all the time," although an expansion allowing addition of 24 beds occurred in 1968.

In 1970, during the Internal Revenue Service investigation, an attorney was retained to review "the current corporate status of the hospital." Counsel recommended "a complete reorganization of the hospital and its affiliates," establishment of "a new profit corporation with the same name," and "that the old non-profit corporation be merged into it."

The Delaware for-profit corporation, JMHC, was formed in 1971 and a supposed merger was arranged. This merger was reported on tax returns filed in 1972, but the record is devoid of documents to support such a transaction. However, Dr. Tauber, who mainly orchestrated the myriad transactions involved in this case, testified, "In my own mind, [the merger] was completed." The chancellor said no evidence had been presented to show due diligence was used at that time to protect the interests of the beneficiaries of the charitable hospital.

The basis of the 1972 Internal Revenue Service ruling revoking JMHI's tax-exempt status was: "The hospital sold 8% bonds to various doctors and individuals in exchange for their 6% demand notes and did not enforce collection of such demand notes. Other hospital bonds were sold to the general public at 8% for cash. Some of the doctors receiving the 9% bonds in exchange for their 6% demand notes were officers, directors, and staff members of the hospital. Issuance of 8% bonds to these doctors and failure to enforce collection of the demand notes received in exchange resulted in *inurement of income to private individuals*." This was a violation of the applicable provision of the Internal Revenue Code allowing exemption of charities from federal income taxation.

In 1974, after another attorney had been retained "to rectify the problem that had arisen" because of the putative merger, documents indicate that JMHC assumed the charity's liabilities in return for receipt of JMHI's assets.

The charity was to receive 5,000 shares of JMHC stock, but no such transfer was made.

The record amply supports the following findings of the chancellor. "There are numerous transactions shown, some of-record and some not, dealing with the real estate, the equipment, the leases, and the use of tax benefits. The transactions show an entire course of self-dealing by the directors of the charity. They were able to acquire interests in the real estate, the equipment and lease, and were able to use tax benefits belonging to the former charity to enhance the gain of the for-profit corporation. The record is replete with discussions among [defendants] as to their personal profits and gains with no reference to the best interests of the beneficiaries nor of the charitable corporation. The result was the total obliteration of the non-profit corporation."

A transaction illustrative of the foregoing conclusions involves a subdivision of the hospital's real estate in 1970. The charity's 65% undivided interest was lost and, in its place, the charity obtained a 20% interest consisting of an allocated parcel. Also, after the nonprofit corporation was dissolved by Maryland authorities in 1973, defendants caused the filing of an annual report with the State Corporation Commission of Virginia that JMHI remained in good standing.

As the chancellor found, deals were "convoluted and complex with off-record real estate transactions conflicting with the state of the title as shown on-record. Net operating losses were used as tax deductions by JMHC that had become deductions [as] a result of the revocation of JMHI's tax exempt status. When [defendants] had exhausted these deductions, they began seeking ways to benefit their own tax status through a complicated series of notes and bonds, and while some personal risk was taken, the [defendants] and others were participating in the venture in basically a risk-free manner."

Defendants claimed in the trial court that JMHI had no value in 1971 and, thus, the transactions by which they assumed control of its corporate assets by the assumption of its liabilities were "fair." Responding, the chancellor determined that JMHI "had value as a 'going concern'" when the effort was made to change to a for-profit corporation. But the court concluded that defendants' expert testimony was more persuasive than plaintiffs' and that "the value of the corporation did not exceed its liabilities." "However," the chancellor ruled, "this does not constitute a defense to the claims made here."

The defendants' contentions regarding the merits of the suit, including the arguments advanced by amici curiae supporting defendants, are premised upon several erroneous conclusions. For example, defendants believe the trial court recognized that a legally valid "transaction" of some sort occurred in 1971.

Defendants' description of the nature of this binding "transaction" has evolved from "merger," to "reorganization," and finally, during oral argument of the appeal, to "acquisition." Also, defendants and their supporters think this case involves the improper meddling by the Commonwealth into the internal affairs of a Maryland corporation, contrary to settled law and violative of the Full Faith and Credit, Due Process, and Commerce Clauses of the United States Constitution. This case involves none of the above.

The trial court determined that no transaction in the nature of a merger or reorganization took place in 1971. The chancellor ruled that "no merger of JMHI and JMHC has occurred and that the transactions by directors of JMHI are void, the assets remained in JMHI until its dissolution. At the time of dissolution, these assets passed into and remain in the hands of [defendants] as trustees." This ruling is fully

supported by the applicable law and the uncontradicted evidence, most of which was created by defendants.

Because the 1971 "transaction" never occurred, the 1973 revocation of JMHI's corporate charter converted its directors by operation of law to trustees in dissolution under Maryland law. Md. Code Ann., Corporations Art. 23, § 78(a) (1957); *Cloverfields Improvement Ass'n v. Seabreeze Properties, Inc.*, 373 A.2d 935, 939-40 (Md. 1977). Virginia law was and is the same. *See* former Code § 13.1-254 (1973 Repl. Vol.); present Code § 13.1-915 (1993 Repl. Vol.).

The charter revocation terminated JMHI's corporate existence and powers, and it could no longer function as a corporation. *Cloverfields Improvement Ass'n v. Seabreeze Properties, Inc.*, 362 A.2d 675, 679 (Md. App. 1976). From that day forward, the defendants' actions purportedly taken as corporate officers, and not done to wind up or liquidate the business, were without effect because there was no corporation for which to act. The corporate assets had automatically transferred to the directors as trustees. *Cloverfields*, 362 A.2d at 679.

Under Maryland law, property of a charitable corporation is held in trust for the public. *Inasmuch Gospel Mission, Inc. v. Mercantile Trust Co. of Baltimore*, 40 A.2d 506, 510 (Md. 1945). Virginia law is the same. "The corporation was organized for charitable or benevolent or literary purposes. Contributions made to it and the assets realized therefrom were dedicated to those purposes and stamped with a public interest by the charter, the laws of this State, sound reason and public policy. The members acquired no property rights in, nor were they equitably entitled to such assets, either during the lifetime of the corporation or upon dissolution. To hold otherwise would convert the public nature and purpose of the corporation into a vehicle for the personal pecuniary gain of the members." *Hanshaw v. Day*, 202 Va. 818, 824, 120 S.E.2d 460, 464

(1961). Thus, the defendants' contentions that this litigation, dealing with appropriation of charitable assets by directors for their personal gain, involves impermissible interference by Virginia with the internal affairs of a foreign corporation, or that a "fairness" doctrine should be applied to the 1971 activities, are without merit.

Accordingly, the circuit court properly exercised its authority to insure that these assets, now held by the defendants as trustees in liquidation, are distributed in accord with the charitable purposes to which they should have been devoted. This power to liquidate the assets and business of a nonstock corporation may be exercised over the property within the court's jurisdiction "of a foreign corporation that has ceased to exist." Code § 13.1-909(B). *See* former Code § 13.1-257(e) (1973 Repl. Vol.). The corporate facilities were located solely within this State in Alexandria.

Thus, we hold the trial court did not err in taking charge of the liquidation of the assets of this dissolved foreign corporation, and in providing the relief outlined in the order from which this appeal was taken. This record clearly demonstrates that the directors of JMHI, now trustees in dissolution, have failed and refused to execute the trust.

Finally, we have considered, and reject, defendants' other arguments. Only one of those contentions merits discussion. Defendants argue the trial court erred in not sustaining its plea based on the doctrine of laches.

Laches may not be pled successfully as a defense in an equitable proceeding to bar the State from asserting a claim on behalf of the public. *Board of Supervisors of Tazewell County v. Norfolk and W. Ry. Co.*, 119 Va. 763, 790, 91 S.E. 124, 133 (1916). *Accord City of Manassas v. Board of Supervisors of Prince William County*, 250 Va. 126, 132, 458 S.E.2d 568, 571 (1995). *See Dick Kelly Enter. v. City of Norfolk*, 243 Va. 373, 381, 416 S.E.2d 680, 685 (1992). As we already have said, this cause is brought by the

Commonwealth on behalf of the public to hold and administer charitable assets. Hence, laches does not apply.

Consequently, we will affirm the judgment appealed from, an interlocutory decree adjudicating the principles of the cause, and we will remand the cause to the trial court for further proceedings.

*Affirmed and remanded.*

## APPENDIX M

## CIRCUIT COURT OF ALEXANDRIA VIRGINIA

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**February 7, 1997**

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Re: Commonwealth of Virginia, *ex rel.* v. Tauber, *et al.*
Chancery No. CH961241

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Dear Counsel,

This matter is before the Court for a decision on the merits after trial. Upon consideration of the testimony, the exhibits filed, and the argument of counsel, the Court concludes that Complainant is entitled to the relief sought in the Bill of Complaint. The Court will enter a declaratory judgment that the assets of Jefferson Memorial Hospital, Inc. (JMHI) remain in the hands of Respondents as trustees; a custodian will be appointed to administer the assets; an accounting will be ordered; and a constructive trust imposed on all assets of JMHI. The relief sought by way of money damages will be denied.

The issues presented are dealt with as follows under the laws of Virginia:

### I. STANDING OF COMPLAINANT TO BRING ACTION.

The Court has previously ruled in the pretrial proceedings that the Attorney General has standing and authority to bring this action both at common law and

pursuant to Title 13.1, Code of Virginia, § 909(B). The Commonwealth's Attorney for the City of Alexandria is a proper party to the claims based upon Title 55, Code of Virginia, § 29.

In view of the express provisions of § 13.1-909(B), the fact that JMHI was incorporated in Maryland does not bar the Attorney General from bringing this action in Virginia. Respondents' reliance on the prohibition against the Commonwealth from regulating the "organization and internal affairs of a foreign corporation" found in § 13.1-923(C) is misplaced as this action does not seek to regulate any organization nor any internal affairs of JMHI.

Therefore, the Court concludes that this action is properly brought.

## II. BURDEN OF PROOF.

In view of the Court's finding that the transactions shown were void (as set forth later herein), the Court has allocated the burden of proof as follows:

A. The burden rests upon Complainant to prove that the transactions are void as a breach of trust by Respondents by a preponderance of the evidence. *Baylor v. Beverly Book Co.*, 216 Va. 22 (1975); *Giannotti v. Hamway*, 239 Va. 14 (1990). Since there is an indication by way of *dicta* in *Willson v. Kable*, 177 Va. 668 (1941) that the proof must be "clear, strong, and cogent", the Court also finds that Complainant has carried such a burden.

B. Respondents have argued that the nature of transactions places this case in the line of authority that makes the transactions voidable not void. Hence, they argue they are entitled to show the fairness of the transactions. *See, Owens v. Owens*, 196 Va. 966 (1955). While the Court does not agree that the transactions are merely voidable, in such circumstances Complainant would be required to make a *prima facie* showing of misdealings and the burdens of

going forward and ultimate persuasion would rest upon Respondents to show the fairness by convincing evidence. *Owens, supra,* at 972.

## III. FACTS.

There is no real conflict in the evidence as to the facts surrounding the transactions and they are simply supported by the documents admitted into evidence.

After the acquisition of real estate by deed and lease by the King Street Joint Venture (KSJV) during 1962, 1963, and 1964, held by Respondent Tauber as trustee for the joint venture, a for-profit corporation was formed to transact the business of operating a hospital. The for-profit corporation was chartered in Maryland in 1963 and authorized to do business in Virginia in the same year.

In 1964, the corporate charter was amended to a "Section 501(c)(3) charitable, non-profit corporation" and JMHI did business as such until 1971. The Internal Revenue Service began investigating the possible revocation of the tax-exempt status of JMHI in 1969, culminating in the revocation in 1971. The Board of JMHI had retained counsel but withdrew its protests to IRS and accepted the revocation. Counsel was retained, according to the uncontradicted evidence, to make recommendations regarding the conversion of the corporation to for-profit status with an eye to the public sale of stock.

A Delaware for-profit corporation, Jefferson Memorial Hospital Corporation (JMHC) was formed in 1971 and a putative merger was arranged. The merger, referred to as a "F" merger, was reported on tax returns filed in 1972. The record is devoid of documents to support the merger but Respondents contend that the merger had occurred "in the minds of the directors." No evidence has been presented to show that at that time due diligence was used to protect the interests of the beneficiaries of the charitable hospital.

Efforts were made later in 1971 and again in 1973 to effectuate the merger. Documents indicate that JMHC assumed all of the liabilities of the charity in return for its assumption of JMHI assets. The charity was to receive 5,000 shares of stock in JMHC. No transfer of the stock has been made.

There are numerous transactions shown, some of-record and some not, dealing with the real estate, the equipment, the leases, and the use of tax benefits. The transactions show an entire course of self-dealing by the directors of the charity. They were able to acquire interests in the real estate, the equipment and lease, and were able to use tax benefits belonging to the former charity to enhance the gain of the for-profit corporation. The record is replete with discussions among Respondents as to their personal profits and gains with no reference to the best interests of the beneficiaries nor of the charitable corporation. The result was the total obliteration of the non-profit corporation.

As one example, the subdivision of the real estate in 1970 in which JMHI had a 65% undivided interest resulted in the loss of this interest. In its place, JMHI obtained a 20% interest consisting of an allocated parcel. No explanation is offered. In 1973, the non-profit corporation was dissolved by the State of Maryland for failure to file necessary property taxes and filing fees. In spite of this, Respondents caused to be filed a certificate with the Commonwealth that the corporation remained in good standing.

The record reveals that the interests of the charitable corporation (and hence, the beneficiaries of the charity) were given no consideration by the directors who were operating out of motives of self-gain and inurement.

The transactions are convoluted and complex with off-record real estate transactions conflicting with the state of the title as shown on-record. Net operating losses were used as tax deductions by JMHC that had become deductions are a

result of the revocation of JMHI's tax exempt status. When Respondents had exhausted these deductions, they began seeking ways to benefit their own tax status through a complicated series of notes and bonds, and while some personal risk was taken, the Respondents and others were participating in the venture in basically a risk-free manner.

Respondents claim that JMHI had no value at the time it was changed to a for-profit corporation and, therefore, the transactions by which they assume control of the corporate assets by the assumption of its liabilities were fair.

The evidence as to the valuation of this entity is conflicting. The experts have disagreed not only in their conclusions but with the methodology employed. The Court finds that in 1971, the time of the change to for-profit, the corporation (JMHI) had value. It had value as a "going concern" with growing revenues but an erratic pattern of net earnings. However, Respondents' experts are the more persuasive and the Court finds that Respondents have carried their burden of showing that the value of the Corporation did not exceed its liabilities.

However, this does not constitute a defense to the claims made here for reasons that follow:

## IV. TRUSTS.

As used in this opinion, the term "void" is construed to mean voidable at the election of the *cestui que* trust.

The directors of a not-for-profit corporation hold the assets in trust for the beneficiaries and their duties are identical to those imposed on trustees of a trust. *Adelman v. Conotti Corp.*, 215 Va. 782, 789 (1975).

In *Rowland v, Kable*, 174 Va. 343 (1940), the Court drew a distinction between those cases where the directors profit from the property of their corporation, in which event the transaction is void, and those cases where the director

deals with the corporation with its consent, in which event the transaction is merely voidable if unfair. The Court, quoting *Deford v. Ballentine Realty Corporation*, 164 Va. 436, 440 (1935), said in stating the majority rule:

> There is a distinction to be made between transactions occurring directly between a trustee and his *cestui que* trust and those transactions in which the trustee deals with himself in respect to the trust estate. The latter class of transactions are voidable by the *cestui que* trust at his election without giving any reason or alleging any fraud, or any advantage of inadequacy of price. *Rowland, supra*, at 368-69.

The actions of these directors are voidable at the option of the beneficiaries of the trust imposed upon them without proof of an actual injury. *See, Rowland, supra*, at 366; *See also, Kessler v. Commonwealth Doctors Hospital*, 212 Va. 497 (1971). In the case of a charitable non-profit corporation, the public as represented by Complainant are the beneficiaries of the trust.

At common law, then, Respondents hold the assets of JMHI in trust for the public.

In addition, it is clear under Virginia law (Maryland law being similar) that directors of a dissolved corporation become formal trustees upon dissolution and hold for the benefit of the creditors and shareholders if for-profit or for the public if non-profit. Since the Court finds that no merger of JMHI and JMHC has occurred and that the transactions by directors of JMHI are void, the assets remained in JMHI until its dissolution. At the time of dissolution, these assets passed into and remain in the hands of Respondents as trustees.

Under Title 13.1 Code of Virginia, § 909(B), this Court has the authority to liquidate the assets and business of JMHI at any time after termination of its existence and whether the corporation was domestic or foreign. The corporation (JMHI) has property and interests located here and no where else. Section 13.1-910 provides the method for liquidation by appointing receivers to manage, wind up and liquidate the corporation.

Pursuant to Title 55, Code of Virginia, § 29, where trustees of any trust such as that imposed on directors of a non-profit corporation refuse to act then the Court may, in an action against the trustees, appoint trustees to execute the trust. Here there is little doubt that the trustees, the directors of JMHI, have refused to execute the trust; thus, this Court may appoint substitute trustees.

## V. LACHES AND GOOD FAITH.

Respondents claim that an undue delay, some twenty-four (24) years from the date of the initial transaction complained of, coupled with the death and disability of witnesses and parties, has resulted in prejudice to their ability to present a defense. Complainant argues that laches, as raised by Respondents, does not apply to the Commonwealth and that the real party in interest is the Commonwealth.

The Court ruled at pretrial that Respondents would not be barred from presenting evidence on this issue; relying on authorities that seemed to hold that laches may apply in cases of a charitable corporation but that equity was reluctant to apply the doctrine in such cases. *See*, Bogert, *The Law of Trusts & Trustees*, § 411, 948 and 949 (1984).

It has been said that Courts of equity are less inclined to apply the doctrine to a charitable trust or against a government. *Mount Vernon Mortgage Corp. v. United*

*States*, 236 F.2d 724, (D.C. Cir. 1956), *Cert. Denied*, 77 S. Ct. 386 (1957).

In Virginia, neither the statute of limitations nor laches may be asserted as a defense in an equitable proceeding to bar the state from asserting a claim on behalf of the public. *Supervisors v. N.&W.R. Co.*, 118 Va. 763, 790 (1916), as cited in *City of Manassas v. Board of Supervisors*, 250 Va. 126 (1995). The Court concludes that this cause is brought by the Commonwealth "on behalf of the public" and not to protect private interests as argued by Respondents. Hence, laches does not apply.

Even if the doctrine could be asserted, Respondents have not carried their burden of showing that the doctrine should bar this action. While the passage of time is significant, no evidence of substantial prejudice has been shown. The transactions questioned by Complainant are clearly documented and are basically not in dispute.

No showing has been made as to what evidence Respondents have been prevented from presenting as a result of the deaths and disabilities alleged. There is one example in which JMHC was identified by an accountant who has since died as JMHI well after the purported merger. Respondents argue that this would have been shown to be a mistake by the accountant. The circumstances surrounding the document are evidence from which the Court could conclude such an error and no prejudice results to Respondents.

In addition, there is no persuasive evidence that the Commonwealth had such notice of the change in the corporate structure as to trigger its right to act. The documents reveal at best confusion and at worst an intent to mislead the authorities as to the structure of the hospital. The continued use of JMHI's tax identification number, the off-record transactions, the use of JMHI's operating license to operate the hospital, the attempts to "clean up" the

transaction in later years, and failure to record and file proper documents all serve to indicate a lack of notice to Complainant. With the heavier burden resting on Tauber's shoulders because of the nature of the claim, it is clear that there has been no showing of laches in this case.

Respondents argue that they were operating in good faith and argue that many of the transactions were done with advice of counsel. In view of the Court's finding that the nature of the transactions render them void not voidable, the good faith of Respondents, even if shown, would not be a defense and the transactions are voided at the election of the *cestui que* trust. *Kessler, supra*, at 503.

In any event, the record reflects a failure on Respondents' part to give full and complete information to counsel when advice was sought and, therefore, the advice could not be asserted as a defense. If this defense was available, it would require a showing of acting in good faith on advice of reputable counsel after full disclosure of the facts. *Edwards v. Carey*, 219 Va. 90 (1978) (a case dealing with an action for malicious prosecution).

## VII. RES JUDICATA.

Respondents in 1994 filed a bill in this Court to quiet title to the real property at issue in this case. Service was had by publication against unknown parties claiming an interest. The Commonwealth was not identified as a party nor served with process.

Respondents now claim that Complainant is barred by its failure to intervene and respond in that suit to protect its interests. *Res judicata* would not apply under these circumstances. *O'Hara v. Pittston Co.*, 186 Va. 325, at 344-346 (1947).

Respondents failed to join the Commonwealth when they knew of the existence of the potential claim and they now assert that the Commonwealth was a necessary party to

the quiet title action so that it is bound by the judgment. Having failed to join a known party whom they claim to be necessary to an adjudication of the issues, the Respondents cannot now be heard to complain of the failure of the Commonwealth to respond.

## VIII. REMEDIES.

Having granted the relief sought the Court must fashion the remedy. Counsel should schedule a prompt hearing to discuss the possible methods for carrying out the Court's ruling including appointment of a Commissioner in Chancery, substitute trustees, or custodians.

Counsel may also wish to consider whether judicial economy is best served by an appeal pursuant to Title 8.01, Code of Virginia, § 670(B) (3), if they are so advised.

Complaint shall prepare for presentation a decree embodying the ruling of the Court.

Very truly yours,
/s/
Alfred D. Swersky

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

---

CHANCERY NO. CH961241

---

COMMONWEALTH OF VIRGINIA, *et al.*,
*Complainants*

v.

LASZLO N. TAUBER, *et al.*,
*Respondents*

---

ORDER

This cause came to be heard upon the merits at a trial commencing on January 21, 1997, until its conclusion; upon the testimony, exhibits and argument of counsel. It appearing to the Court for the reasons stated and fully set forth in its opinion letter dated February 7, 1997, which letter is incorporated herein, it is

ORDERED, ADJUDGED and DECREED that a declaratory judgment be, and it hereby is, entered that the assets and liabilities of Jefferson Memorial Hospital, Inc., be, reside and remain with Respondents as trustees and further that a constructive trust be and it hereby is imposed on such assets and liabilities; further, it is

ORDERED, ADJUDGED and DECREED that a custodian, the identity to be determined by this Court, be

appointed with exclusive jurisdiction to hold and administer the said assets and liabilities in whatever form and wherever located; further, it is

ORDERED, ADJUDGED and DECREED that the Respondents shall prepare and submit under oath a full and complete accounting of all assets and liabilities that are the subject of this Decree within sixty (60) days hereof and Complainant shall respond within thirty (30) days of the receipt, which accountings shall disclose all rents, issues, profits, accretions, and benefits, tangible and intangible, which have accrued therefrom and further proceedings shall be had and further evidence taken, if necessary, by this Court; further, it is

ORDERED, ADJUDGED and DECREED that Respondents shall not convey any property, real, personal, tangible, or intangible, without approval by decree of this Court and Complainant shall cause a copy of this Decree to be spread among the land records of the City of Alexandria or any other jurisdiction wherein such property may be located; further it is

ORDERED, ADJUDGED and DECREED that the custodian appointed by this Court shall submit for approval by this Court a plan for the use of disposition of the assets and liabilities of Jefferson Memorial Hospital, Inc., and further, it is

ORDERED, ADJUDGED and DECREED that Complainants' claim for monetary damages be and it hereby is denied.

Entered this 3rd day of March, 1997.

/s/

Alfred D. Swersky
Judge

The objections of all parties as noted in the record are hereby preserved.

Copies to all Counsel of Record

## APPENDIX N

***VIRGINIA:***

*In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on* Friday *the* 7th *day of* June, 2002.

Laszlo N. Tauber, et al,. Appellants,

against Record No. 011150
Circuit Court Nos. CH961241
and CH970488

Commonwealth of Virginia, ex rel.
Jerry W. Kilgore, Attorney General
of Virginia, et al., Appellees.

Upon a Petition for Rehearing

On consideration of the petition of the appellants to set aside the judgment rendered herein on the 19th day of April, 2002 and grant a rehearing thereof, the prayer of the said petition is denied.

A Copy,

Teste:

/s/

Clerk

## APPENDIX O

## CONSTITUTIONAL PROVISIONS

Article I, § 8, Clause 3

> The Congress shall have Power To ... regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

Article IV, § 1

> Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof.

Amendment XIV, § 1

> All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.

**APPENDIX P**

IN THE
SUPREME COURT OF VIRGINIA
AT RICHMOND

---

RECORD NO. 011150

---

LASZLO N. TAUBER, LESLIE L. PETERS, IRWIN S. FREEDMAN, ESTATE OF SAMUEL BURTOFF, MICHAEL A. CORRADO, DAN J. FERIOZI, LESLIE P. GONDOR, REGINALD P. MCMANUS, MAGDOLNA A. IRANYI, ESTATE OF JAMES H. SCULLY, JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE, JEFFERSON MEMORIAL HOSPITAL, INC., JEFFERSON MEMORIAL HOSPITAL ASSOCIATES, JEFFERSON MEMORIAL HOSPITAL CORPORATION, JEFFERSON CORPORATION OF ALEXANDRIA, THE TAUBER FOUNDATION, AND THE CHARITABLE REMAINDER UNITRUST,

Appellants-Respondents,

v.

COMMONWEALTH OF VIRGINIA, *ex rel.*, JERRY W. KILGORE, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; JERRY W. KILGORE, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; AND THE COMMONWEALTH'S ATTORNEY FOR THE CITY OF ALEXANDRIA,

Appellees-Complainants.

---

APPELLANTS' PETITION FOR REHEARING

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* * * * *

ARGUMENT

**I. THIS COURT'S FAILURE TO FOLLOW MARYLAND LAW, WHICH THIS COURT HELD WAS CONTROLLING, AND ITS FORECLOSURE OF APPELLANTS' OPPORTUNITY TO PRESENT EVIDENCE ON JMHI'S DISSOLUTION INVOLVING THE SALES OF ALL OF ITS ASSETS AND LIABILITIES VIOLATES THE DUE PROCESS AND FULL FAITH AND CREDIT CLAUSES OF THE UNITED STATES CONSTITUTION.**

First, this Court ruled that its prior decision (Tauber I) "mandated" a finding that the sales of JMHI's assets in 1975 and 1982 were without legal effect because the Appellants acted "as corporate officers" and "there was no corporation for which to act." Tauber II at 19. This Court refused to recognize these transactions solely because "there is no indication the transactions in 1975 and 1982 were entered into by the defendants as trustees in dissolution of JMHI, . . . rather than as directors." Tauber II at 20. This holding is directly contrary to controlling Maryland law, which this Court failed to apply, thus violating the Full Faith and Credit Clause of the United States Constitution.

Second, with respect to the 1982 transaction, the issue is more fundamental: the Chancellor in the first trial made no findings, and could not have made any findings, concerning the 1982 transaction because this issue was never before the Chancellor in the first trial. Thus, this Court did not rule, and could not have ruled, on the 1982 transaction in the first appeal in Tauber I. Accordingly, it was a fundamental violation of due process for this Court now to hold that "the 1982 transactions with HGV did not constitute acts of the defendants as trustees in dissolution to 'wind-up' the corporate affairs of JMHI" based on this Court's "holdings in Tauber I." Tauber II at 20.

The evidence in the first trial was limited by the Chancellor to the time period from the inception of JMHI in 1965 until only 1976. No evidence was presented to the Chancellor on any transaction after 1976, let alone the 1982 transaction with HGV. Thus, at the first trial, no evidence was permitted after 1976, the 1982 transaction with HGV were never addressed, and this Court in the prior appeal could not have held that the 1982 transaction was not a winding up of JMHI.

It is well established that where the government acts to deprive one person of property and award it to another, that person must be afforded some fair procedure to determine whether his property should be taken and transferred to another. See Sniadach v. Family Finance Corp., 395 U.S. 337, 89 S.Ct. 1820, 23 L.Ed.2d 349 (1969). The general elements of fair procedure include the rights to adequate notice of the proceedings, a fair and neutral decision maker, and an opportunity to present evidence. See, e.g., Brock v. Roadway Exp., Inc., 481 U.S. 252, 262-64, 107 S.Ct. 1740, 1748-49, 95 L.Ed.2d 239 (1987). Thus, this Court's holding that its prior decision in Tauber I mandated its rejection of the 1982 HGV transaction as a wind-up of JMHI violates the basic precept of due process, which is the opportunity to present evidence prior to a ruling.

Likewise, the 1975 transaction had been structured to wind-up JMHI under Maryland law and was not, as the Commonwealth suggested on appeal, a "hypothetical" dissolution. At the trial, the Commonwealth presented no evidence of any kind by any fact or expert testimony to dispute the 1975 sale of JMHI assets, and the evidence presented by Appellants at trial was clear and undisputed. Indeed, the Commonwealth's *own expert*, Professor Dooley of the University of Virginia, was forced to concede that a charity, as JMHI did here, is dissolved "by selling [the charity's] assets and then by having another corporation begin to carry on the same business." App. at 0093; see also App. at 2376, 2397. At trial, the undisputed evidence showed that in 1975, the directors of *JMHI*, acting for *JMHI*, through corporate records of *JMHI*, took those very actions. In January 1975, the directors of *JMHI* held a special meeting coordinated by their corporate counsel to authorize the sale of all of *JMHI's* assets and liabilities to JMHC. App. at 2902-03; see also App. at 1785-86. The purpose of the meeting was to wind-up the affairs of *JMHI* and to dispose of all of its assets and liabilities. ***All of the members of JMHI attended this meeting.*** At the meeting, the members were presented with the resolution of the board of directors, who had been converted by operation of law to trustees in dissolution. They recommended that the members give their "approval of the sale of the assets of the corporation to Jefferson Memorial Hospital Corporation, a Delaware corporation." App. at 2902-03; see also App. at 1785. The minutes of the special meeting of the members of JMHI further stated:

> After a full discussion of the problems of the corporation by the members, and of the resolution from the Board of Directors to the members recommending the approval of the sale of the corporation's assets, in consideration of the assumption of its liabilities, it was duly moved,

> seconded and unanimously carried, that the sale of the corporation's assets to Jefferson Memorial Hospital Corporation, a Delaware Corporation, as recommended by the Board of Directors of this corporation, be and the same is hereby approved as being in the best interests of this corporation and its creditors.

App. at 2902-03. Each of the members of *JMHI* signed the minutes of this special meeting. This conduct complied precisely with what the Commonwealth's Professor Dooley testified the members of JMHI were authorized and required to do to wind up *JMHI*.

Thus, there is no doubt that the 1975 transaction was an act in dissolution, and the only question that this Court should have considered was whether the transaction was effective under Maryland law without the JMHI directors calling themselves "trustees in dissolution." This Court previously held that the Appellants retained the authority to wind up and liquidate the affairs of JMHI, because the corporate assets had automatically transferred to the directors as trustees. See Tauber I, 255 Va. at 455, 499 S.E.2d at 844 (citing Md. Code Ann., Corporations Art. 23, §§ 78(a) (1957)). However, this Court has now held that the 1975 transaction was not an act in dissolution, relying solely upon Mrs. Vella's testimony that "in order for the directors to act pursuant to a forfeited charter, they would have to make this decision as trustees." Tauber II at 9. In its opinion, this Court ignored, as did Mrs. Vella, governing Maryland law concerning the dissolution of a Maryland not-for-profit corporation, which this Court was bound to apply to the 1975 transaction.

In Cloverfields Improvement Association, Inc. v. Seabreeze Properties, Inc., 280 Md. 382, 373 A.2d 935 (1977), the Maryland Court of Appeals set forth the law of Maryland,

which this Court cited as authoritative in Tauber I but failed to apply here:

> . . .where a man has several capacities, and is found in possession of property, the law will attach the possession to the capacity in which, of right, it ought to be held; so also, where having various capacities, he executed an authority delegated to him in one of those capacities, the law will attribute the act to the proper authority, although the person does not profess to exercise it, in virtue of that particular power.

Id. at 399 (citing Flickinger v. Hull, 5 Gill. 60, 74-75 (1847)).

Thus, under Maryland law, even though the trustees in dissolution of JMHI may have signed their resolution as directors of JMHI, App. at 2898-2904, Maryland law requires that such winding-up be held to have been made in their capacity as trustees in dissolution. Similarly, Maryland law elevates substance over form, providing that an individual or company that executes a document, with some mistake to title or name, has effectively executed the document, and Maryland law will not invalidate such an action. Curtis G. Testerman Company v. Buck, 340 Md. 569, 667 A.2d 649 (1995); Citizens Bank of Maryland v. Maryland Industrial Finishing Co., Inc., 388 Md. 448, 659 A.2d 313 (1995). Thus, this Court's refusal to give effect to the 1975 transaction because the JMHI board members signed the minutes as directors, rather than trustees in dissolution, violates the Full Faith and Credit Clause of the United States Constitution.[1]

---

[1] Likewise, an equity court has the authority to reform written instruments with mistakes, in order to effectuate the intent of the parties. Mutual Life Ins. Co. of Baltimore v. Metzger, 167 Md. 27, 172 A. 610

This Court previously ruled that Maryland law governs the dissolution of the Maryland not-for-profit JMHI, see Tauber I, 255 Va. at 455, 499 S.E.2d at 845, and the guarantees of Full Faith and Credit of the United States Constitution mandate that this Court apply Maryland law to a Maryland not-for-profit corporation. See Order of United Commercial Travelers v. Wolfe, 331 U.S. 586 (1947); Allstate Ins. Co. v. Hague, 449 U.S. 302 (1981). This Court has failed to apply Maryland law in several important instances.[2] Thus, this Court's holding that the former directors of JMHI could not wind-up the corporation because of its prior opinion in Tauber I, and because they did not effect the 1975 and 1982 transactions as "trustees in dissolution" in name, violates the Due Process Clause and Full Faith and Credit Clause of the United States Constitution.

* * * * *

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(1934); England v. Gardiner, 154 Md. 510, 142 A. 625 (1928); Simmons v. Simmons, 37 Md. App. 202, 376 A.2d 1147 (1977); see also Holland v. Vaughn, 120 Va. 324, 91 S.E. 122 (1917).

[2] For example, Maryland Code § 5-208(b) governs the dissolution of the assets and liabilities of a former Maryland not-for-profit corporation. Maryland Code § 3-515(c) also specifically provides that "director-trustees" of a Maryland corporation that has forfeited its charter are empowered to "[d]o all other acts consistent with law and the charter of the corporation necessary or proper to liquidate the corporation and wind up its affairs."

**APPENDIX Q**

**IN THE**
**SUPREME COURT OF VIRGINIA**
**AT RICHMOND**

---

**RECORD NO. 011150**

---

LASZLO N. TAUBER, LESLIE L. PETERS, IRWIN S. FREEDMAN, ESTATE OF SAMUEL BURTOFF, MICHAEL A. CORRADO, DAN J. FERIOZI, LESLIE P. GONDOR, REGINALD P. MCMANUS, MAGDOLNA A. IRANYI, ESTATE OF JAMES H. SCULLY, JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE, JEFFERSON MEMORIAL HOSPITAL, INC., JEFFERSON MEMORIAL HOSPITAL ASSOCIATES, JEFFERSON MEMORIAL HOSPITAL CORPORATION, JEFFERSON CORPORATION OF ALEXANDRIA, THE TAUBER FOUNDATION, AND THE CHARITABLE REMAINDER UNITRUST,

Appellants-Respondents,

v.

COMMONWEALTH OF VIRGINIA, *EX. REL.*, RANDOIPH A. BEALES, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; RANDOLPH A. BEALES, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; AND THE COMMONWEALTH'S ATTORNEY FOR THE CITY OF ALEXANDRIA,

Appellees-Complainants.

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**BRIEF OF APPELLANTS**

---

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* * * * *

## II. THE TRIAL COURT ERRED BY NOT APPLYING MARYLAND LAW TO THE DISSOLUTION, WINDING UP, AND PROSPECTIVE DISTRIBUTION OF ASSETS OF A MARYLAND NOT-FOR-PROFIT CORPORATION, JEFFERSON MEMORIAL HOSPITAL, INC.

This Court has clearly ruled that Maryland law governs the dissolution of this Maryland not-for-profit and the distribution of its assets. See Tauber, 255 Va. at 455, 499 S.E.2d at 845. Accordingly, the trial court erred by applying Virginia law to determine the liability of the directors or trustees in dissolution of the Maryland not-for-

profit corporation JMHI and to govern the distribution of this entity's assets.

The trial court failed to apply Maryland law in several important instances. The trial court failed to apply Maryland law regarding the operation and dissolution of a not-for-profit corporation. Maryland Code § 2-405.1 provides a statutory safe-harbor for the directors of non-profit corporate charities from liability arising out of conflicts of interest. Similarly, Maryland Code § 5-208(b) governs the distribution of any assets of a former Maryland not-for-profit corporation. Finally, Maryland law provides that an insider transaction involving corporate directors cannot be voided where the transaction is fair to the corporation. See Chesapeake Constr. Corp. v. Rodman, 261 A.2d 156 (Md. 1970).

However, the trial court refused to hold a hearing concerning whether the directors and trustees took their actions in good faith, so as to fall under the "safe harbor" protection for directors and trustees of non-profit corporations under Md. Code Ann. § 2-405.1 and § 2-419. App. at 0035. This failure to apply Maryland law constitutes reversible error because Maryland law provides a presumption that directors of a corporation act in good faith and in the best interest of the corporation. See Wittman v. Cooke, 707 A.2d 422 (Md. App. 1998). Similarly, contrary to this Court's prior opinion, the trial court ruled that "the distribution of assets described herein and subject to the constructive trust imposed by this Court shall be in accord with and subject to Virginia *cy pres* rules and not Maryland's corporate dissolution statutes." December 21, 2000 Decree at 7 (emphasis in original). The trial court also arbitrarily refused to hold that the 1975 sale to JMHC constituted the winding up and liquidation of JMHI, thus ignoring Maryland law. App. at 0031. Similarly, the trial court failed to apply the Maryland fairness rule, thus permitting the

Commonwealth to elect to void the 1975 liquidation which constituted the winding up of JMHI. App. at 0031.

The trial court offered no explanation for its decision to apply Virginia law to the distribution of the assets subject to the constructive trust, nor any explanation why it denied the individual appellants an opportunity to be heard concerning the statutory safe harbor for trustees of not-for-profit corporations. App. at 0035. Finally, it is the Commonwealth that bears the burden of showing that the individual trustees in dissolution did not act in good faith and, despite the absence of any evidence presented by the Commonwealth that the trustees in dissolution acted other than in good faith, the trial court found the individuals personally liable.

* * * * *

**APPENDIX R**

**VIRGINIA:**

**IN THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA**

| | |
|---|---|
| COMMONWEALTH OF VIRGINIA, ex. rel. ) MARK EARLEY, ATTORNEY GENERAL OF VIRGINIA; MARK EARLEY, ATTORNEY GENERAL OF THE COMMONWEALTH OF VIRGINIA; and THE COMMONWEALTH'S ATTORNEY FOR THE CITY OF ALEXANDRIA, | ) CHANCERY ) NO. 961241 |
| Complainants, | |
| v. | |
| LASZLO N. TAUBER, ET AL., | |
| Respondents. | |

**POST-TRIAL BRIEF OF RESPONDENTS JEFFERSON MEMORIAL HOSPITAL JOINT VENTURE, JEFFERSON MEMORIAL HOSPITAL, INC., JEFFERSON MEMORIAL HOSPITAL ASSOCIATES, JEFFERSON MEMORIAL HOSPITAL CORPORATION, JEFFERSON CORPORATION OF ALEXANDRIA, LASZLO N. TAUBER, M.D., LESLIE L. PETERS, M.D., IRWIN S. FREEDMAN, M.D.**

**AND ON BEHALF OF THE TAUBER FOUNDATION**

Dated: April 7, 2000

* * * * *

## II. FACTUAL ANALYSIS OF ACCOUNTING FOR JMHI'S ASSETS AND LIABILITIES

### A. JMHI Was Dissolved and Its Assets Properly Sold in Dissolution.

The Supreme Court of Virginia held that the Maryland dissolution statute for nonstock corporations governs the accounting phase of this case. Section 5-208(b) of the Maryland Code provides:

> (b) *Distribution of assets on dissolution or forfeiture.* – If a Maryland nonstock corporation dissolves or its charter is forfeited:
>
> (1) Every liability and obligation of the corporation shall be paid and discharged or adequate provision for payment and discharge shall be made;
>
> (2) Assets held by the corporation subject to legally valid requirements for their return, transfer, or conveyance on dissolution or forfeiture shall be disposed of in accordance with these requirements.
>
> (3) Assets held by the corporation subject to limitations permitting their use only for charitable, religious, eleemosynary, benevolent, educational, or similar purposes, but not held subject to legally valid requirements for their return, transfer, or conveyance by reason of dissolution or forfeiture, shall be transferred or conveyed under a plan of distribution, adopted in the manner and by the vote required for authorization of dissolution of the corporation, to

one or more Maryland or foreign corporations or associations having a similar or analogous character or purpose, or associated or connected with the corporation;

(4) Other assets shall be distributed as provided in the charter or the bylaws to the extent that the charter or bylaws determine the distributive rights of members or any class or classes of members, or provide for distribution to others; and

(5) Any remaining assets may be distributed to any person, society, organization, or Maryland or foreign corporation specified in a plan of distribution, adopted in the manner and by the vote required for authorization of dissolution of the corporation.

This Court is to determine whether, at the time of JMHI's dissolution on April 18, 1973, there were any net assets remaining for distribution to a similar organization after all of JMHI's liabilities were paid. It is clear that JMHI's liabilities far exceeded its assets, and this Court has already reached this conclusion in the first trial. Accordingly, there are no assets of JMHI subject to a constructive trust, and no income or profits are attributable to JMHI's assets. As Mr. Cobb explained: "If I had nothing to invest, if my assets were consumed by my liabilities and upon liquidation or winding up I had zero, I would have zero to invest and zero at my investment rate grows to zero." (Tr. (Cobb) at 42.)

Professor Dooley from the University of Virginia Law School, the Commonwealth's expert witness on corporate governance, testified concerning corporate dissolutions in general and with respect to JMHI in particular. Professor Dooley explained: "In essence, what the corporation does in order to end its legal existence is to

begin a process of dissolution. In dissolution, assets and liabilities are accounted for, liabilities are discharged, and the remaining assets are then distributed." (Tr. at 528-29.) He further explained that in a not-for-profit corporation, the "members of the corporation" are authorized to approve the dissolution, and that "once the members have approved the act of dissolution the corporation is to cease doing business and to devote its efforts entirely to carrying out the liquidation and dissolution." (Tr. at 530.) In particular, Professor Dooley noted that "in 1973, according to official state records, JMHI ceased to have any corporate existence at all because its charter has been revoked by the State of Maryland." (Tr. at 534.) Professor Dooley further testified that "[b]eginning in 1974 and then eventually in 1975" JMHI's minutes recite that JMHI "has agreed to sell its assets to JMHC in exchange for JMHC's assumption of those liabilities." (Tr. at 533-34.) In his testimony, Professor Dooley made clear that this conduct by the members of JMHI constituted action taken in dissolution. Professor Dooley explicitly testified:

> Q. But if the non-profit is providing medical services and they determine that the only way they can continue to provide medical services is to change the corporate form, there are appropriate ways of doing that, are there not?
>
> A. Yes. By dissolving and <u>then by selling those assets and then by having another corporation begin to carry on the same business</u>.

(Tr. at 554) (emphasis added.)

This is precisely what JMHI did in this case. In 1974, Respondents asked J. Thorpe Richards, Esq., to document the sale of JMHI's assets and liabilities to JMHC. (Tr. (Tauber) at 58.) Mr. Richards was the hospital's lawyer

since it opened its doors on March 15, 1965, and he had full access to all of its records, documents and files. No information or documents that Mr. Richards requested were ever denied to him. Dr. Freedman testified that Mr. Richards was engaged to make sure that everything was done properly. The Board minutes confirm Dr. Freedman's testimony. They reflect that in 1974 the directors expressly asked Mr. Richards "to represent the Hospital in looking after and insuring that the Hospital Corporate structure for the past, present, and for the immediate future, be handled so as to insure that everything is legally correct." (Ex. 130.) Mr. Richards accepted this responsibility, and did what he was asked to do.

On the prior appeal in this case, the Virginia Supreme Court stated that "the 1973 revocation of JMHI's corporate charter converted its directors by operation of law to trustees in dissolution under Maryland law." Although the charter revocation terminated JMHI's corporate existence, the Virginia Supreme Court expressly acknowledged that the directors of JMHI, having been converted "by operation of law to trustees in dissolution," were "from that day forward" authorized "to wind up or liquidate the business" of JMHI. As Mr. Cobb explained, he selected April 18, 1973 as the date for his accounting because he understood "that any actions not taken as of the date of dissolution and thereafter, any actions not taken to wind up or liquidate the corporation, were without effect. So I looked at a winding up, a dissolution as of April 18, 1973." (Tr. (Cobb) at 25.)

On January 27, 1975, the members of JMHI, at the direction of Mr. Richards, convened a special meeting. The purpose of the meeting was to wind-up the affairs of JMHI and to dispose of all of its assets and liabilities. All of the members attended. At the meeting, the members were presented with the resolution of the board of directors, who had been converted by operation of law to trustees in

dissolution. They recommended that the members give their "approval of the sale of the assets of the corporation to Jefferson Memorial Hospital Corporation, a Delaware corporation." (Ex. 137). (See also Tr. (Tauber) at 59.) At the meeting, Mr. Richards also "discussed the problems of the corporation, its liabilities and assets, the fact that its liabilities exceeded its assets." (Id.) The minutes of the special meeting of the members of JMHI further states:

> After a full discussion of the problems of the corporation by the members, and of the resolution from the Board of Directors to the members recommending the approval of the sale of the corporation's assets, in consideration of the assumption of its liabilities, it was duly moved, seconded and unanimously carried, that the sale of the corporation's assets to Jefferson Memorial Hospital Corporation, a Delaware Corporation, as recommended by the Board of Directors of this corporation, be and the same is hereby approved as being in the best interests of this corporation and its creditors.

(Ex. 137). Each of the members of JMHI signed the minutes of this special meeting. (Id.) This conduct complied precisely with what Professor Dooley (the Commonwealth's corporate expert)testified the members of JMHI were authorized and required to do. ("By dissolving and then by selling those assets and then by having another corporation begin to carry on the same business.")

The Commonwealth has presented no evidence to the contrary. Indeed, both Mr. Wilson and Mr. Cobb agreed that such conduct is action taken in dissolution. Mr. Wilson testified that winding up a dissolved corporation involves "disposing of assets, discharging liabilities and whatever remains after that winding up shall flow to the owners or whoever is the responsible party." (Tr. Vol. V (Wilson) at

157.) Mr. Wilson also testified that as a result of the dissolution of JMHI on April 18, 1973, "the directors operated as trustees in dissolution as a matter of law." (Tr. Vol. V (Wilson) at 158.)

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## APPENDIX S

P-R-O-C-E-E-D-I-N-G-S

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CLOSING ARGUMENTS

MR. BETTIUS: May it please the Court, Your Honor, on behalf of the Commonwealth of Virginia and the Commonwealth Attorney, the City of Alexandria, on behalf of myself, I offer the following comments in connection with the trial that has taken place in this Court.

And only because I speak first, Your Honor, I think I'm compelled to make the following comments and I think Mr. Bono and the people associated with the defense of this case will agree, this is a user-friendly Court. At all times the staff and the Court have extended to us every possible courtesy in the trial of the case and I think it's important to comment now before we know the decision because obviously one of us is going to dramatically disagree. The Court's conduct of the case has been totally fair and even-handed, and we appreciate that.

Your Honor, the Commonwealth believes that this case has been proved to an overwhelming certainty, and I think that's important when the Court considers that it is our position and we think sustained by every authority that comments on the issue, irrespective of jurisdiction or

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[MR. BONO:] Now, Your Honor, the Attorney General talked about the law, and I would like to address that briefly before I focus on certain facts in the case again. But the law -- I would respectfully submit that the Attorney General has told Your Honor this morning that the law, how they described it, that they described it just wrong and plain

wrong, and I don't understand how the Attorney General can make those representations in this Court.

Number one, this is a Maryland not-for-profit corporation and I would respectfully submit that it is the Maryland corporate code that governs. I would also submit that the Virginia Corporate Code is more or less substantially the same, but, without doubt, the Maryland corporation, which is the only not-for-profit here and the director of conduct, I would submit must be governed by the corporate code of Maryland. The corporate code of Maryland in Section 2-405.1 says and it's titled "Standard of Care Required of Directors," and in subpart B specifically says that in performing their duties, directors have a right to rely on, quote, a lawyer, certified public accountant or other person as to a matter which the director reasonably believes to be within the person's professional or expert competence.

Clearly, as we have addressed in this case, the Board was entitled to rely on lawyers, CPAs and others which have expertise, and the evidence in this case is that they clearly did that.

Now, with respect to the voidability of this transaction, the Attorney General has argued now for the first time, in contradiction to what they argued to this Court at the beginning of this case, that this transaction, because it involved they say insider directors, is somehow void automatically.

I would remind the Court, as I did in my opening statement last week, that at the beginning of this case in the original opening statement of the Attorney General the Attorney General said point-blank that the directors could have done what they did here, that it was not void as a transaction by itself, and that they could have done it. And in fact their expert witnesses, particularly Mr. Dooley, did not take any position that the transaction was void and in fact

he testified that in his judgment and opinion he would not bring on any independent directors to deal with the conversion because independent directors were not as a practical matter available, they would not serve, and in fact his bottom-line recommendation was, I wouldn't recommend to this Board that they try to get somebody from the outside.

Now, let me address what the law is; not what the Attorney General says it is but what the law is. And that's contained in Maryland Code Section 2-419. And it clearly says -- as to interested director transactions, says that the transaction may not be voided or voidable solely because that there are common directorships or interests. And it says that that situation applies and that the transaction is not void or voidable if the contract or transaction is fair and reasonable to the corporation. And that is contained in Section 2-419(b)2, and that is the Code of Maryland.

Now, the Attorney General will argue, as he's tried to do, that, oh, well, that Code didn't apply in 1971, and I'll mention I believe the code provision in Maryland was adopted in 1976.

Well, common law of Maryland was precisely the same, and I will cite to the Court the case of Cummings v. United Artist Theater Circuit, Court of Appeals of Maryland, which is the 237 Maryland 1, a 1964 case, and there the Court outlined what at that time was the common law in Maryland and it said exactly what the Code says of Maryland that was subsequently adopted, and it says, quote: The generally-accepted rule is that fairness is the proper test. And then this it quotes from a treatise Latin on law of corporations and it says: This rule is practical and tends to produce the sort of contract or other transaction where strict adherence to directorial duties and other circumstances tend to produce; that is, a fair contract. It gives the corporation protection in case of unfair contract which is all of the protection it needs.

The common law of Maryland was precisely as the statute of Maryland provides. This transaction is not void as the Attorney General argues and the issue is the one that we have presented to this Court: Was the transaction fair?

I would also note that the Attorney General has talked about how this non-profit corporation ought to have been dissolved, and this morning he argued that somehow they should not have allowed it to dissolve. At least that's the gist now of his argument this morning.

Originally he was arguing that the respondents killed JMHI, but now he's says, well, they didn't dissolve it and it should have been dissolved.

Well, as Your Honor knows, the facts are that the charter of the Maryland corporation was in fact revoked. The testimony was that was pursuant to the advice of Attorney Krakow of how to do that in the cheapest, most efficient manner so that the not-for-profit would not incur any additional fees and attorneys fees, and, again, it is the statute of Maryland which governs the dissolution of a Maryland not-for-profit corporation. And it provides in Section 5-208 precisely how that should be done and it's just like Professor Dooley says and it's precisely what the respondents did in this case.

It says you must account for your liabilities and then you must pay those liabilities or make provision for their payment, and that's precisely what JMHI and its directors did. It provided for the provision of the payment of every dollar of liability of JMHI. The respondents didn't walk away from that. They assumed them. They personally assumed them, either personally or through JMHC, just like the statute says you have to do.

And just like Professor Dooley says, he says only after you do that, and that's what the statute of Maryland says, only after you do that must you then deal with any

remaining assets and how they are to be distributed. And it was the judgment of the Board of Directors here that after payment or provision of those liabilities, there were no remaining assets to be paid to anyone or to be distributed to charity in 1971.

Now, it is that judgment that the Attorney General, a quarter of a century later, seeks to second guess, and there is no doubt whether they can hold that they are technically governed by laches or not or what, but they are here in 1997 asking this Court to make a judgment that what the directors thought and believed and analyzed in 1971 was wrong, and that's their case.

And, Your Honor, I would respectfully submit that in any decision that Your Honor makes, you must view it in terms of looking at something that happened a quarter of a century ago. And you have been given the unenviable task of almost putting yourself back in time 25 years, and I would respectfully submit that this burden is enormous, that it is almost impossible for any human being to turn back the clock a quarter of a century, because, in doing that, all of the influences that have impacted all of us in the last 25 years must somehow being taken out of our minds, taken out of our existence, and it's precisely that problem that we're dealing with today.

The Attorney General's case is based upon a 1997 analysis of things that happened in 1971, and they like to say that now directors of not-for-profits want to make basically make sure they're not going to be sued, so now in today's world they go out and they get outside appraisals and they get fairness opinions and we all know that's done now because the purchase of not-for-profit hospitals is a very hot topic today, and the Attorney Generals see this as an area where they are going to scrutinize it, and so now everybody does all the belts and suspenders. They dot every "I," cross every "T."

Well, in 1971, as Mr. Richards explained, and there is no counter-evidence to that in this case, he explained exactly what he did in 1975 and what recommendations and advice he gave this Board when he was specifically given the task by the Board to do what was

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## APPENDIX T

VIRGINIA: IN THE CIRCUIT COURT OF THE CITY OF ALEXANDRIA

JAMES S. GILMORE, III,
ATTORNEY GENERAL of the
COMMONWEALTH OF VIRGINIA,

Complainant

v.

IN CHANCERY NO. CH950516

LASZLO N. TAUBER, SAMUEL BURTOFF, MICHAEL A. CORRADO, DAN J. FERIOZI, IRWIN S. FREEDMAN, LESLIE P. GONDOR, REGINALD P. McMANUS. LESLIE L. PETERS, MAGDOLNA A. IRANYI, and JAMES H. SCULLY, each individually and as a former director of Jefferson Memorial Hospital, Inc. (a now defunct Maryland corporation), and/or as partners in Jefferson Memorial Hospital Associates, or Jefferson Memorial Hospital Joint Venture, and/or directors or shareholders of Jefferson Memorial Hospital Corporation (a Delaware Corporation now known as "Jefferson Corporation of Alexandria"), and

JEFFERSON MEMORIAL HOSPITAL ASSOCIATES, a partnership, and

JEFFERSON MEMORIAL HOSPITAL JOINT

VENTURE, a partnership,
and

JEFFERSON
CORPORATION OF
ALEXANDRIA, a
Delaware corporation,

Respondents

BILL OF COMPLAINT

1. James S. Gilmore, III, brings this action in his official capacity as Attorney General of the Commonwealth of Virginia pursuant to the Attorney General's common law authority and duty to enforce and supervise charitable trusts and gifts.

2. This Court has jurisdiction by virtue of Va. Code § 17-123 and its inherent equitable authority to supervise charitable gifts and charitable organizations.

3. Venue is proper in the Circuit Court of Alexandria because the conduct complained of occurred largely in Alexandria, Virginia, and the hospital involved is or was located at 4600 King Street in Alexandria, Virginia.

4. Respondents LASZLO N. TAUBER, SAMUEL BURTOFF, MICHAEL A. CORRADO, DAN J. FERIOZI, IRWIN S. FREEDMAN, LESLIE P. GONDOR, REGINALD P. McMANUS, LESLIE L. PETERS, MAGDOLNA A. IRANYI, and JAMES H. SCULLY are sued individually and as former directors of Jefferson Memorial Hospital, Inc., (a now defunct Maryland corporation) and/or its successors in interest, and/or as partners in Jefferson Memorial Hospital Associates, a partnership, or Jefferson Memorial Hospital Joint Venture, a partnership, and/or directors or shareholders of Jefferson

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49. Prior to or at the time of these 1974 resolutions, the JMHI Directors did not advertise the hospital for sale and did not seek potential purchasers other than JMHC.

50 In 1974, when the JMHI Directors sold JMHI's assets for nothing more than JMHC's assumption of its debts totaling $399,000, plus interest, as described above, the Hospital and its assets had a fair market value of at least $4,000,000.00 on the open market.

51. The $399,000.00, plus interest, in debt assumed by JMHC included $319,000, plus interest, which JMHI owed to some or all of the JMHI Directors.

52. The purported $400,000 consideration given by JMHC was grossly inadequate in relation to the assets JMHI delivered to JMHC and in relation to the price JMHI would have brought on the open market. The purported $400,000 consideration was also grossly inadequate in its failure to compensate JMHI for the income stream that JMHC commandeered to its own benefit from the time of the purported 1971 merger.

53. JMHI's assets included the Berman Lot and Lot No. 3821-03-02, both owned in fee simple,[1] the balance of the 99 year Hopkins Leasehold, the balance of the 99 year lease on Gondor's Lot No. 3821-03-01, the balance of its 40 year lease on the Hospital building and improvements (with 19 year renewal option), its licenses or certificates of need from the Commonwealth, its goodwill, and some equipment. Additionally, JMHI had some right, the exact terms of which are unknown to the Complainant, to use or occupy Lots No. 3821-03-03 and 3821-03-04. The January 29, 1975, JMHC board minutes reflect that JMHC valued the owned land at

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[1] See Exhibits A and B.

$188,851, and the equipment at $85,851. It further reflected the only other asset to be "a 20% interest in a 99-year lease on a small strip of ground ..."[2] No value was assigned to the 99 year Gondor lease or the Hopkins Leasehold. No mention or value was given to the Hospital's certificates, license to operate, building lease from Associates, its rights to use or occupy Lots No. 3821-03-03 and 3821-03-04, its value as an ongoing concern, or its value in the open market if advertised and offered for sale.

54. On or about March 13, 1974, the Directors of JMHC, including Respondents Tauber, Burtoff, Corrado, Gondor, Iranyi, McManus and Peters voted to transfer the Hospital land and building to a reinstituted KSJV, with everyone getting an interest in the KSJV partnership equal to the percentage of stock he owned in JMHC.

55. On or about November 27, 1974, the stockholders of JMHC resolved to sell the Hospital land and building to Tauber as trustee for a partnership to be formed. The partnership to be formed was apparently the reinstituted KSJV contemplated by the JMHC Directors in their meeting of March 13, 1974.

56. On or after January 2, 1975, Associates took in more partners and changed its name to, or was succeeded by, Jefferson Memorial Hospital Joint Venture ("JMHJV"), a partnership of approximately 57 individuals believed to include Respondents Tauber, Corrado, Burtoff, Feriozi, Freedman, Gondor, McManus, Peters, Scully and others. JMHJV was the "reinstituted partnership" contemplated at the JMHC Directors' meeting of March 13, 1974.

57. On or about December 24, 1974 or June 1, 1975, JMHC sold, gave or assigned its land to JMHJV for

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[2] In fact, by an unrecorded January 1, 1966, Assignment of Lease, JMHI actually held 100% of the Hopkins Leasehold.

$240,000.00 above the outstanding amount owed on a first mortgage.

58. On or about February 1, 1975, JMHI conveyed the Berman parcel and Lot 3821-03-02 to JMHC, excluding the improvements thereon.

59. On or about July 1, 1975, JMHI and JMHC executed two versions of a document entitled "Lease Cancellation." These recite that the January 1, 1966, lease and January 2, 1966 sublease between Associates and JMHI "is cancelled" due to execution of new lease between Respondent Tauber, Trustee for JMHJV (successor to KSJV) and JMHC, "successor to JMHI." Other than an implied release from the obligation to pay rent in the future and perform other covenants of the lease, no consideration was given to JMHI for this termination of its 40 year lease with 19 year renewal option.

60. On or about October 27, 1976, JMHI assigned its 99 year lease in the Hopkins Leasehold to Tauber as Trustee for JMHJV.

61. During the 1970s, large national hospitals like Humana and Hospital Corporation of America ("HCA") were buying hospitals across the country. Hospitals with certificates of need like the Hospital commanded premium prices.

62. The JMHI Directors owed to JMHI common law, statutory or fiduciary duties of loyalty and diligence. As Directors, the JMHI Directors were obligated to avoid conflicts of interest or self-dealing with JMHI. They were obligated to oversee JMHI in such a way that it would not violate the law or its articles of incorporation. They were further required to exercise that same standard of care in overseeing JMHI that a reasonable person would have exercised in his or her own personal affairs.

63. Said duties imposed certain requirements upon the JMHI Directors in the sale or other disposition of JMHI or its assets. In particular, in the sale of JMHI or its assets, the JMHI Directors were legally bound to seek the highest and best price. The proceeds of such sale were required by law to be donated to another charitable organization or to the government. Alternatively, in the donation of JMHI as an entity or in the donation of its assets, the JMHI Directors were legally obligated to donate only to another charitable organization or the government. JMHI could not simply absolve itself of its previously undertaken charitable duties and its charter's prohibitions against private gain.

64. In the conduct described above, JMHI Directors, Respondents Tauber, Iranyi and Scully breached their fiduciary duties of loyalty and care: (A) by failing to explore and promote the sale of the Hospital to third parties like Humana and HCA; (B) by failing to seek any bidders or buyers other than JMHC, in which Respondent Tauber and perhaps other held a material interest; (C) by failing to obtain anything close to the $4,000,000.00 fair market value of JMHI; (D) by canceling, or agreeing to the cancellation of, the 40 year lease of the Hospital building held by JMHI without receiving fair consideration; (E) by canceling or assigning without consideration the 99 year lease of Gondor Lot No. 3821-03-01; (F) by releasing or assigning the right to use or occupy Lots No. 3821-03-03 and 3821-03-04 without receiving fair consideration; (G) by their ultra vires self-dealing in their use of the Hospital from 1971 to 1974 without payment of fair consideration; and (H) by transferring the Hospital building, land and assets to their own for-profit corporation, JMHC, in 1974 through 1976, for grossly inadequate consideration.

**ALLEGATIONS RELATING TO THE TRACING OF ASSETS AND IMPOSITION OF A CONSTRUCTIVE TRUST**

65. Respondents Gondor, Freedman, Burtoff and Iranyi, as members of the JMHC Board of Directors, had actual or constructive knowledge of the transaction by which JMHI transferred the leased Hospital building, owned and leased land and other JMHI assets to JMHC without adequate consideration and in breach of the fiduciary duties owed to JMHI by its Directors, and by their conduct described above, conspired with Respondents Tauber, Scully and Iranyi to deprive JMHI of the leased Hospital building, owned and leased land and other JMHI assets.

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WHEREFORE, Attorney General James S. Gilmore, III, prays that the Court:

1. order each Respondent to account for the money or other value he has received in these transactions;

2. surcharge of JMHI Directors Respondents Tauber, Scully and Iranyi, and the JMHC Directors Respondents Gondor, Freedman, Burtoff and Iranyi, all jointly and severally, for the charitable assets which they usurped, took or sold in 1971 and/or 1974, the amount of said surcharge to be proved at trial but to total at least $4,000,000.00;

3. grant judgment to the Commonwealth of Virginia against the JMHI Directors Respondents Tauber, Scully and Iranyi, and the JMHC Directors Respondents Gondor, Freedman, Burtoff and Iranyi, all jointly and severally, in an amount to be proved at trial but of at least $4,000,000.00, to be applied by the Commonwealth when collected to indigent or other charitable health care or maintenance;

4. grant judgment to the Commonwealth of Virginia against the JMHI Directors Respondents Tauber, Scully and Iranyi, and the JMHC Directors Respondents Gondor, Freedman, Burtoff and Iranyi, all jointly and severally, for pre-judgment interest at the various judgment rates in effect from 1971 to the present to be applied by the

Commonwealth when collected to indigent or other charitable health care or maintenance;

5. trace the assets taken from JMHI in order to impose a constructive trust upon the Hospital, its land, equipment and any other assets, and the settlement proceeds being paid by INOVA to JMHJV (or at least the share of Respondents Tauber, Corrado, Feriozi, Gondor, McManus, Peters, Freedman, Scully and any others proved to have knowledge of or responsibility for the transactions described above), and, through said constructive trust, take the Hospital, its land, equipment and any other assets, and the said is INOVA settlement proceeds and devote them all to charitable health care and maintenance;

6 award the Commonwealth of Virginia its costs and attorneys' fees in the investigation and prosecution of this case; and

7. grant such other relief as is just and equitable.

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